FISCAL YEAR 1988 SMALL BUSINESS ADMINISTRATION BUDGET

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

WASHINGTON, DC, FEBRUARY 26; MARCH 4 AND 5, 1987

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FISCAL YEAR 1988 SMALL BUSINESS ADMINISTRATION BUDGET

THURSDAY, FEBRUARY 26, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 9:31 a.m. in room 2359-A, Rayburn House Office Building, Hon. Ike Skelton (acting chairman of the committee) presiding.

Present: Acting Chairman Skelton; Representatives Torres, Olin, Mfume, Lancaster, Campbell, Ireland, Dreier, Meyers, Gallo, McMillan, Combest, Hefley, and Upton.

Acting Chairman Skelton. The Committee on Small Business will come to order. My name is Ike Skelton, and I am substituting for Chairman John LaFalce this morning, because he has to be elsewhere on another commitment that he just cannot miss. And those of us on the committee understand that those things do happen from time to time.

At this point, rather than reading the entire prepared statement of Chairman LaFalce, I ask unanimous consent to place it in the record, so that it may be reflected when the record is printed.

[Chairman LaFalce's opening statement, with attachments, follows:]

OPENING STATEMENT OF CHAIRMAN LAFALCE

The hearing will come to order.

I am pleased this morning to convene the first hearing of the Small Business Committee during this historic 100th Congress. It is entirely fitting that our witness this morning is Mr. Charles L. Heatherly, Acting Administrator of the Small Business Administration, and that the topic is the Administration's budget request for SBA for Fiscal Year 1988. Welcome, Mr. Heatherly.

I want to note at the outset that although I am pleased to have Mr. Heatherly here today, I had hoped that a new administrator would have been nominated and confirmed. I find it particularly distressing that the agency has not had a permanent administrator for the past ten months and that major program changes are being proposed without any input from whoever is going to assume the helm.

The budget submitted for the Small Business Administration proposes a number of changes, some of which are very substantial. I am not going to enumerate all of them, but I would simply note that summaries prepared by the Committee staff have been made available to the Members. Suffice it to say that the budget proposals involve:

--major changes in guarantee programs and the elimination of direct loans targeted to minorities, to handicapped, and to veterans;

--sale of assets (which parenthetically I want to note will be the subject of hearings by this Committee next month);

--transfer of the Minority Business Development Agency to SBA and reduction in SBA programs to assist minority enterprise development;

--elimination of the Small Business Development Center management assistance program; and

--imposition of user charges in eighteen major areas.

I want to state for the record that I am not opposed to change per se. In fact, before the end of this Congress I intend to propose substantial changes in the Small Business Administration as SBA cannot be all things to all people. Its resources are severely limited and may become more limited in the future, and thus it is essential that we rifle assistance to targeted groups rather than use a shotgun approach.

On the other hand, let me make it equally clear that the continued existence of SBA is not a subject of debate. That issue was settled in the affirmative last year, and I will not tolerate proposals to emasculate programs and simply leave an empty shell; and I am very suspicious that some of this year's proposals, if approved, may have that result, whether intentional or not.

Finally, I want to note that I am looking forward this morning to receiving the details of this year's proposals. The information received to date is too sketchy and leaves many unanswered questions. I expect this morning's testimony to fill in the budget outline, particularly with regard to the submission of legislation from the administration to accomplish the proposals and their enumeration of those proposals which they do not believe requires statutory change.

DATE: January 28, 1987
RE : Summary of Administration's Budget Proposal for SBA

The President's budget for SBA for Fiscal Year 1988 basically contains the same program levels as appropriated for 1987 except that he would eliminate direct loans to the handicapped, to Vietnam Veterans and to minorities. The changes may be grouped as follows:

1. Minority Assistance

A. 7(j) call contracts: these grants to provide counseling would be cut in half from $9.6 million to $4.8 million and would be restricted to trade groups only.

B. Business development expense: these grants would be eliminated ($17 million in 1987).

C. MESBIC preferred stock: these purchases would be eliminated ($19 million in 1987). Approximately $14 million of regular SBIC guarantees would be made available to minorities as a substitute.

D. Minority business development agency: the MBDA (now at Commerce under executive order) would be transferred to SBA.

E. Direct loans: eliminated ($24 million in 1987).

2. Business Loan Programs

A. Consolidation: sub-category loan programs providing handicapped, economic opportunity and energy would be consolidated into the general 7(a) loan program.

B. Loan guarantee fees: these fees would be doubled. Three percent would be collected from the borrower (now 2 percent) and an additional 1 percent would be collected from the lender.

C. Loan guarantee percentage: reduce the maximum loan guarantee to 75 percent (now 90 percent on loans of $155,000 or less and 70-85 percent on loans over that amount except reductions permitted on a case-by-case decision or requested from the lender for admission into the preferred lender's program.

D. Direct loans: direct loans would be eliminated (minority ($24 million in 1987); handicapped ($15 million in 1987); and veterans ($19 million in 1987).

3. Disaster Loans (effective in Fiscal Year 1989)

A. Credit-worthy: deny disaster loan assistance to any victim which can obtain credit elsewhere (now made at an interest rate of 7½ to 8 percent).

B. Non-credit-worthy: increase the interest rate to cost-of-money (now 4 percent).

4. SBDC Centers

A. Funding formula: reduce the funding formula to a national basis of $45 million (centers now are eligible based on their population as compared to total U.S. population as computed on a $65 million national program), thereby reducing the cap or maximum amount of eligibility per state by 30 percent.

B. New states: no states not now in the program would be admitted (at the present time seven states do not participate).

C. Phase-out: once they reach their new cap, existing participants would have the amount of their eligibility reduced each year until all SBDC funding would be eliminated in five years.

D. Reduce FY'87 funding: reduce FY 1987 funding level (now $35 million) by $4.1 million and transfer availability to FY 1988.

5. Sale of assets

SBA again is projecting loan asset sales commencing this year.

The current SBA loan portfolio as of November 30th includes the following assets:

Disaster loans - $4,262.4 million
Business loans - $1,321.2 million
FFB-503 - $837 million
Regular SBIC - $1,189.3 million
MESBIC debentures - $127.1 million
MESBIC preferred stock - $204.4 million

During Fiscal Year 1987, SBA projects the sale of disaster loans in an amount sufficient to yield $277 million. Based on prior OMB estimates, they believe they can accomplish this yield by selling an estimated $800 million in disaster loans. Additional sales would occur in FY 1988 as follows:

Type of Loan	Proceeds Needed	Estimated Amount to be Sold FY'88
Disaster	$254 million	$740 million
Business	$140 million	$ 1 billion
FFB/503	$249 million	$500 million

6. Pollution Control Bonds

This program would be eliminated.

7. New Fees: A number of new or expanded fees would be imposed, bringing in a total of about $83 million annually on eighteen items. The major items include:

A. An additional 2 percent guarantee fee on loan guarantees ($45 million);

B. A fee on earnings from secondary market transactions, i.e., the sale by the bank of guaranteed loans ($15 million);

C. Additional surety and contract fees ($8 million); and

D. Additional guarantee fee on development company guarantees ($5 million).

8. Miscellaneous

A. SBIC guarantee: reduce to 90 percent (now 100 percent)

B. Surety Bond Guarantee level: increase to $1.25 billion (now $1.142 billion).

SMALL BUSINESS ADMINISTRATION
FY 1988 CONGRESSIONAL SUBMISSION
ANALYSIS OF ADDITIONAL REVENUE ESTIMATES BY ACTIVITY
($ IN THOUSANDS)

05-Jan-87

PROGRAM/PROJECT	Requested Amount	Estimated Receipts	Explanation of Revenues
PASS	$1,700	$1,700	Annual listing fee of $10 and hourly usage fee of $30
Certificates of Competency	2,139	400	Application fee of $200
Small Business Institutes	2,071	1,435	Fee for counseling at $ 200 per case
SCORE	2,120	1,000	Fee for training @ $25.60 per attendee
Business Development Publications	400	257	Current charges for publications
Women's, Vet's, & IT Conf. & Publ.	1,943	1,095	Fee for publications and fee for conference attendees
State of Small Business	50	50	Fee for publication
Small Business Innovation Research	1,214	75	Annual subscription fees @ $5 each
Advocacy Database	1,900	225	Sale of Customized and Standardized Data Base Outputs
Hearings and Appeals	1,073	65	Size and SIC Appeals at $200 per appeal or protest
Other Salaries and Expenses	292,767	250	Fee for 8(a) program applicants
Subtotal	308,250	7,332	
Business Loan & Investment Fund	100,730		
		45,000	Additional 2% Guaranty Fee on General Business Guaranty Approvals
		350	Additional 1% Guaranty Fee on 502 BCL Guaranty Approvals
		5,070	Additional 1.5% Guaranty Fee on 503/504 BCL Guaranty Approvals
		2,330	Additional 1% Guaranty Fee on SBIC Guaranty Approvals
		15,000	20% of premium earned on Secondary Market transactions
Subtotal		67,750	
Disaster Loan Fund	0	5,000	Increase int. rates comparable with bus. loans & keep the 1% add-on
Surety Bond Fund	15,000		
		2,630	Increase in surety fee to 25% of $18 fee
		5,200	Increase in contractor's fees to $8/1000
Subtotal		7,830	

SMALL BUSINESS ADMINISTRATION
Program Levels
($'s in Millions)

	1983 Actual	1984 Actual	1985 Actual	1986 Appropriated*	1986 Actual	1987 Appropriated	1988 President
General Business Loans	$2,179.9	$2,554.0	$2,392.6	$2,491.0	$2,129.5	$2,473.0	$2,494.0
Direct & IP	85.5	89.7	77.4	-0-	-0-	-0-	-0-
Guaranteed	2,094.4	2,464.3	2,315.2	2,491.0	2,129.5	2,473.0	2,494.0
Handicapped Loans	16.5	16.4	24.4	19.2	15.3	20.0	-0-
Direct & IP	14.9	16.0	23.6	14.4	14.3	15.0	-0-
Guaranteed	1.6	.4	.8	4.8	1.0	5.0	-0-
Economic Opportunity Loans	47.0	59.7	57.9	81.4	45.6	80.0	-0-
Direct & IP	16.5	18.5	15.4	24.0	13.6	24.0	-0-
Guaranteed	30.5	41.2	42.5	57.4	32.0	56.0	-0-
Energy Loans	3.6	1.8	.9	14.4	-0-	14.0	-0-
Direct & IP	.4	.3	.1	-0-	-0-	-0-	-0-
Guaranteed	3.2	1.5	.8	14.4	-0-	14.0	-0-
Development Company Loans	296.0	348.3	311.8	382.8	353.2	373.0	373.0
Direct & IP	---	---	4.0	-0-	-0-	-0-	-0-
Guaranteed	296.0	348.3	307.8	382.8	353.2	373.0	373.0
Investment Company Loans	186.9	197.3	309.1	278.4	175.0	272.0	267.0
Direct & IP	27.0	37.5	44.2	39.2	39.0	39.0	20.0
Guaranteed	159.9	159.8	264.9	239.2	136.0	233.0	247.0
Veterans Loans	6.4	19.7	8.6	19.1	19.1	19.0	-0-
Direct & IP	6.4	19.7	8.6	19.1	19.1	19.0	-0-
Guaranteed	---	---	---	---	---	---	-0-
Total Business Loans	2,736.3	3,197.2	3,105.3	3,286.3	2,737.7	3,251.0	3,134.0
Direct & IP	150.7	181.7	173.3	96.7	86.0	97.0	20.0
Guaranteed	2,585.6	3,015.5	2,932.0	3,189.6	2,651.7	3,154.0	3,114.0

*includes 4.3 percent Gramm-Rudman reduction.

SMALL BUSINESS ADMINISTRATION
Program Levels (Cont.)
($'s in Millions)

	1983 Actual	1984 Actual	1985 Actual	1986 Appropriated	1986 Actual	1987 Appropriated	1988 President
Disaster Loans	198.5	314.2	318.3	574.2	516.2	325	350
Physical	198.5	314.2	267.6	564.2	510.0	325	350
Non-physical	---	---	50.7	10.0	6.2	-0-	-0-
Surety Bond Guarantees	567.4	571	959.1	1,050.0	1,043.9	1,096	1,250
Pol. Control Bond Guarantees	8.0	11	7.4	47.8	25.5	75	-0-
Salaries & Expenses (outlays)	287.8	258.3	267.1	298.8	283.1	289.3	304.2

Acting Chairman **Skelton**. At this time, I ask the ranking gentleman from Florida, if he would care to comment at this time.

Mr. **Ireland**. Thank you, Mr. Chairman. The situation here indicates that our subcommittee has taken over the full committee with you as chairman.

Acting Chairman **Skelton**. I think so.

Mr. **Ireland**. Our minority ranking member, Mr. McDade is ill, and we wish him a speedy recovery, and know that he will be back soon.

I am delighted today to welcome Mr. Heatherly to the kickoff of the 100th Congress. We look forward to hearing from him and visiting with him as the Congress unfolds. Thank you, Mr. Chairman.

Acting Chairman **Skelton**. Thank you, Mr. Ireland. I wish to thank your witness, Mr. Charles Heatherly, for being with us today to go over the Small Business Administration's budget proposal. Unfortunately, as I have previously mentioned, Mr. LaFalce is not here and I hope that you accept his apologies as well as ours.

The floor is now yours, Mr. Heatherly. We ask that you, without objection, place your entire statement, which I understand is some 90 pages or thereabouts, in the record, and we will ask you to summarize in—I usually say 25 words or less, but I will not do that this morning, but within 10 minutes.

Could you do that, sir?

Mr. **Heatherly**. Yes, sir.

Acting Chairman **Skelton**. Without objection, your statement will be placed in the record.

TESTIMONY OF CHARLES L. HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY LAWRENCE R. ROSENBAUM, ACTING COMPTROLLER; EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT; AND JOHN COX, ACTING ASSOCIATE DEPUTY ADMINISTRATOR FOR SPECIAL PROGRAMS AND BUSINESS DEVELOPMENT

Mr. **Heatherly**. Thank you, Mr. Chairman, and members of the committee. It is a pleasure to come before the committee this morning to discuss the President's proposed budget for fiscal year 1988 and to answer your questions about our proposals.

Accompanying me at the table are Mr. Lawrence Rosenbaum, our Acting Comptroller; Edwin Holloway, Associate Administrator for Finance and Investment; and Mr. John Cox, our Acting Associate Deputy Administrator for Special Programs and Business Development.

I have submitted an opening statement for the record, and as you remarked, it is quite extensive. I have included in it some information on the programs in the agency and several appendices that I think will be of interest to the committee.

Following the President's statement last August to the State chairs of the White House Conference on Small Business indicating the continuation of SBA as a strong voice in the executive branch, I immediately began speaking both to the public and to our own agency staff about the President's commitment to an independent agency. I simultaneously began discussions with the Office of Management and Budget concerning our 1988 proposals.

We reinstituted a more traditional budget development process between the agency and OMB. We had very fruitful, extensive, and detailed discussions down to the mid staff levels, narrowed many of our differences, and came forth with what I believe was a very constructive and pragmatic budget which maintains essential services and program levels while making progress on deficit reduction.

Our proposed budget for 1988 is a dramatic change of direction for the administration's proposals of the 2 previous years. I believe that we are striving to maintain both central services and program levels while simultaneously reducing the net outlays. We are doing this through the institution of reasonable user fees and loan asset sales.

We do not expect universal agreement with our proposals, and we expect to hear alternative concepts in the weeks ahead. We stand ready to discuss new ideas and new formulations regarding our user fee proposal, and we firmly believe that there is widespread support in the business community for our basic strategy, preserving an independent SBA that strives for greater self-sufficiency through reasonable user fees and sound management practices.

Mr. Chairman, my associates and myself would be happy to answer your questions.

[Mr. Heatherly's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF CHARLES L. HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

Mr. Chairman, Members of the Committee, it is a pleasure to come before the Committee this morning to discuss the President's budget proposal for Fiscal Year 1988 and to answer your questions on the administration of the Agency's programs. Accompanying me at the table are Lawrence R. Rosenbaum, our Acting Comptroller, Edwin T. Holloway, Associate Administrator for Finance and Investment, and John Cox, Acting Associate Deputy Administrator for Special Programs. I have submitted to the Committee my opening statement with appendices, which I request be made a part of the record of this hearing.

Before discussing the specific areas of our Fiscal Year 1988 budget proposal mentioned in the Committee's letter of invitation, I would like to review the overall condition of the Agency and highlight a few program initiatives we think are positive and important.

INDEPENDENCE OF SBA

Following the President's statement last August 15 to the State Chairs of the White House Conference on Small Business about the continuation of SBA as a strong voice in the Executive Branch, I immediately began speaking to the public and to our Agency staff about the President's commitment to an independent

SBA. I simultaneously began discussions with the Office of Management and Budget concerning our Fiscal Year 1988 budget.

FY '87 Operating Plans

Looking at our situation last August and in particular the certainty of continued full funding for SBA programs in FY 87, I recognized the need to recover a sense of mission -- and a commitment to renewal and revitalization -- after two years of uncertainty and controversy.

Therefore, in August I initiated a reinvigoration of our annual planning system to put in place a set of written program goals and priorities as guidelines for Agency managers in developing their FY '87 operating plans.

After a series of meetings among program heads and Regional Administrators -- and an extensive exchange of proposals -- On October 15, I issued a set of "Fiscal Year 1987 Goals and Priorities." (Appendix I)

As Acting Administrator, I set out three general principles followed by six program initiatives. They are as follows:

1. Statutory and regulatory requirements are to be observed fully and conscientiously;

2. Service to the small business client is the touchstone for all Agency activities; and

3. Economy, efficiency, and integrity in the use of agency resources are the responsibilities of all employees.

The Agency priorities for FY '87 are:

1. Productivity improvements in all program and administrative operations;

2. Improvement of internal control systems to safeguard resources and assets against waste, fraud, and abuse;

3. Implementation of business development concepts throughout program offices to better focus available resources on demonstrated client business needs;

4. Expanded cooperation and coordination among all SBA units to focus Agency and private sector resources on improved portfolio management to achieve concrete, measurable progress in delinquencies and default rates, with regions and

districts establishing specific goals founded on baseline data and unified efforts;

5. Cost recovery in program administration through user fees and other vehicles where authorized and appropriate; and

6. Improved effectiveness in the 8(a) program through implementation of new regulations and emphasis on private sector markets.

These principles and priorities were followed by thirty pages of program goals -- office by office, program by program -- which comprised the foundation for setting goals in the regional and district offices.

The final step in the chain was the translation of district operating plans into individual performance plans for each employee.

Following the passage on October 17 of our appropriation for FY '87, we immediately issued revised staff ceilings for each region and each Central office unit. The ceilings called for the hiring of 196 additional employees above the September 30 on-board employment level.

Twenty-one of these positions were designated for the breakout PCR program. In addition, ten new positions were designated for a full-time Veteran advocate in each regional office. (Appendix II)

NEW AND PROPOSED REGULATIONS

I want to offer a few highlights of the agency's programmatic achievements over the past 12 months. First, I am attaching a list of new and proposed regulations implemented or promulgated during FY '86. (APPENDIX III) Principal among these new regulations was the comprehensive set of new regulations of Minority Small Business/Capital Ownership Development (MSB/COD) which took effect on November 24, 1986.

Other major regulations issued during this period cover such issues as business loan policies, disaster loans, debt collection, small business investment companies, pooling mechanisms and implementation of new legislation on size standards.

SBIC AND 504 DEBENTURE POOLING

One issue raised last April was the question of how the agency would proceed with the implementation of P.L. 99-272 on the public sale of SBIC and 504 debentures (instead of purchase by the Federal Financing Bank, which is now discontinued)..

Two fundings of the SBIC Program have occurred under the authority of Public Law 99-272. The first sale of certificates closed on September 24, 1986 and funded debentures totalling $67,190,000 issued by 36 licensees.

The debentures and certificates, which carry SBA's full faith and credit guarantee of timely payment of principal and interest, were for a term of ten years at a coupon interest rate of 8.75 percent.

The second sale closed on February 4, 1987 and funded a $49,230,000 pool of twenty-five SBIC ten-year debentures at a coupon interest rate of 7.95 percent. The poolers -- underwriters--for both sales were Citicorp Investment Bank, the first Boston corporation, and Goldman, Sachs & Co.

Four fundings of the 504 Program have occurred under the authority of Public Law 99-272. The first sale of certificates closed on November 12, 1986, and sales have continued on a monthly basis. One Hundred ninety-five debentures have been funded for a total of $41.7 million. The poolers -- underwriters -- for these sales were Merrill Lynch Capital Markets and Citicorp Investment Bank. (APPENDIX IV)

IMPLEMENTATION OF REAUTHORIZED 8(a) PILOT PROGRAM

Public Law 99-567 reauthorized the 8(a) Pilot Program through September 30, 1988 and requires the President to designate a pilot agency for the program. The agency has recommended to the President that the Department of Transportation be designated as the pilot agency. In effect, this acknowledges the intent of the reauthorization that the pilot is to be considered as Part II of the earlier pilot program which expired on September 30, 1985. Others in the Administration felt that it would be more appropriate to select a different agency in order to gain the advantages of a different experience with the pilot concept. After considerable discussion and weighing of the advantages and disadvantages, the recommendation to designate the Department of Transportation has been endorsed by OMB and forwarded to the President; we expect the designation will be announced in a matter of days.

IMPLEMENTATION OF 8(a) PRICE COMPETITION PILOT

During FY 1986, the Small Business Administration signed a Memorandum of Understanding (MOU) with the Department of Navy to implement a price competition pilot project. The MOU (APPENDIX V) allows the SBA and Navy to jointly select, using modified 8(a) procedures, potential procurements which appear to be within the capability of two or more 8(a) firms. The Department of Navy has agreed to issue solicitations to SBA-certified 8(a) firms and to be responsible for all procurement actions up to the point of contract execution. We are dedicated to successful implementation of this program as a vehicle to test the applicability and benefits of price competition within the 8(a) program.

REPORT ON USER FEES

Our September 30, 1986 User Fee Report was transmitted to the Congress in response to the requirements of Section 18011 of Public Law 99-272--The Reconciliation Bill. (APPENDIX VI) The report was prepared by an SBA task force comprised of senior SBA staff officials and program managers.

The report, which addresses a total of 107 agency services, is divided into three sections:

The first section discusses the methodology used to develop the study, lists user fee task force members, and discusses some of the limitations on the use of data.

The second section lists all 29 agency services for which a fee is currently imposed, specifies the amount of that fee, and discusses how that fee was determined.

The third section lists those agency services for which no user fee is currently imposed, presenting them in the following two subsections:

-- Services provided for which no fee is currently imposed, but should be. This section identifies 33 SBA services which are suggested fee candidates.

-- Services provided for which no fee is currently imposed and should not be. This section identifies 45 SBA services which were determined not to be viable fee candidates.

Since the completion of the September 30, 1986 task force report, the agency has continued to work on the user fee issue through:

1) An in-house user fee policy group

2) A National Advisory Council User Fee Task Force

Both of these groups have made recommendations on SBA user fees, and both sets of recommendations significantly modify the recommendations of the September 30 Report.

In addition, at the request of the Administrative Conference of the United States, we have provided comments on a draft report on Federal user fees that was recently submitted to the conference by two professors.

REVITALIZATION OF THE NATIONAL ADVISORY COUNCIL

The SBA National Advisory Council is a valuable asset to the Administrator, and its revitalization has been one of my top priorities.

The NAC should not be used as a vehicle for encouraging grass-roots lobbying for or against agency legislative proposals, as has been done in the recent past.

Under the leadership of a new chair, the NAC has become an active partner in the development of new program initiatives and a valuable resource for agency program managers.

In early September, I had the distinct pleasure of addressing the members of the National Advisory Council at its semi-annual meeting in Scottsdale, Arizona.

I emphasized that it was my desire to strengthen the relationship between SBA and the NAC. Specifically, I expressed my earnest desire to cultivate a strong liaison between key SBA program staff and the NAC Committee chairs. I also called for members of the council to be kept informed of all council decisions and major agency initiatives and to have an opportunity to comment on new regulations and SOPs prior to final action.

Also, in order to ensure that this revitalization expanded to the regional (district-level) advisory councils, last November I directed each of the agency's ten regional administrators to update, improve, and promote to every extent possible, the membership of each advisory council in their regions.

At the September NAC meeting I created three task forces to focus on three high-priority topics. The first was a task force to examine the agency's User Fee Task Force Report to Congress and make recommendations to the Administrator.

The findings of that task force, as I had advised its members when it was established, will be passed on to the new Administrator.

Additionally, I appointed two other task forces comprised of NAC members to review the 8(a) program and our size standards policy. These respective groups have also issued reports that will be shared with the new Administrator.

Finally, I have asked our NAC International Trade Committee to hold a joint meeting with our agency international trade staff and business development experts to reassess our entire international trade effort and recommend new approaches that can guarantee a more successful delivery of information and assistance to the widest possible audience of potential small business exporters. That joint meeting will take place on March 24 in Washington, D.C., and I invite the Committee to send a staff person as an observer.

NEW EMPHASIS ON BUSINESS DEVELOPMENT PROGRAM

In August 1985, the Office of Business Development was reorganized and with that change came a new focus.

The predecessor organization, the Office of Management Assistance, focused on counseling, training, and information dissemination performed in large part through direct intervention by agency personnel using agency resources.

The new role of the Office of Business Development emphasizes the leveraging of resources and the need to manage those resources in order to achieve specific agency objectives.

To ensure the full implementation of the Business Development concept, new Standard Operating Procedures (SOP) were written and are now being implemented. A management monitoring system has been developed that will track the progress made in implementing the program in each field office and employee evaluations will be tied to the results attained.

The new SOP emphasizes strategic planning. It is the aim of Business Development to assist our resource partners to set goals, institute a planning process, and ensure a cooperative spirit that will dovetail with the goals and initiatives of the agency.

Another area of importance within the Business Development SOP is marketing and outreach. Prior to the formation of Business Development, the Agency lacked a central point within the organization to coordinate marketing and outreach activities of the Agency. The placing of this responsibility within Business Development will assure a minimum of duplication of effort among our resources. Specific duties are defined for each level of the Agency's organization so that authorities and responsibilities do not overlap.

We have special programs that need special understanding. Outreach efforts will be increased to the veteran population and women business owners. Great care has been taken to assure that these programs are highlighted within our operating procedures.

REASSESSMENT OF AGENCY'S INTERNATIONAL TRADE PROGRAM

In recent years the Office of International Trade has focused on trade mission activity. This type of activity has had minimal impact when considering the scope of assistance that is needed by small business in the international trade area. The trade mission support is being provided by private sector entities and other organizations. At the present time, the agency's International Trade effort is undergoing a reassessment.

It is clear that if SBA is going to have meaningful impact in the international trade area, it will be in the area of information dissemination and education support through outreach programs such as conferences, seminars, and workshops which identify potential small business exporters and link them with needed information and assistance.

We will be meeting with small business groups, and State and local governments to determine the type of information that does not currently reach the small business community and what educational support is needed. We are soliciting assistance from the private sector to develop and implement these outreach efforts. We will also work with other Federal programs, such as the International Trade Administration (ITA) to make sure that our activities complement theirs.

A closer working relationship with small business organizations, state and local governments, and the private sector will assure that the programs being developed and implemented will have a greater impact on small business.

With me today is Mr. John Cox, Acting Associate Deputy Administrator for Special Programs, who can respond to questions about the new emphasis on international trade assistance in our FY '87 operating plans. Specific goals for this program are included on page 15 in the first appendix to this testimony.

And now, I'd like to give a short overview of the President's FY '87 budget proposals for the Small Business Administration and answer the specific questions asked in your February 9 letter of invitation.

The budget proposals, we believe, are reasonable and pragmatic approaches in light of the Government's overall budget deficit of more than $170 billion in the current fiscal year.

Proposed FY 1988 Budget -- General Comments

The Administration's FY 1988 budget request for the Small Business Administration carefully balances the requirement to reduce the size of the Federal budget deficit with the Congressional intentions inherent in the Federal programs of the SBA that are essential for continued vitality of our small business sector.

This budget looks forward rather than backward. It proposes to concentrate the available resources to meet and address the problems of the future, rather than those of yesterday. The proposed SBA budget requests $379.3 million in new budget authority and a staffing level of 4,227 FTE positions.

This budget submission represents the Administration's recognition of the important position that the small business sector occupies within our economy. Thus the proposed budget takes into consideration two critical requirements for the continued vitality of the small business community:

1. Healthy and steady growth of our economy to encourage entrepreneurship; and

2. Existence of free and competitive markets to allow the competitive spirit of the small business entrepreneur to develop to its full potential.

To achieve this, the Federal budget deficit must be brought under control and eventually eliminated.

Because the Small Business Sector is affected as much as any other sector of our economy by the harmful effects of uncontrolled deficits, the SBA budget proposal makes significant contributions toward deficit control. This is achieved not by any major cutbacks or elimination of any essential programs, but through continued improvements in management and productivity, reduction or elimination of no longer justifiable subsidies through appropriate user fees, and the sale of loan assets.

Now let me address the questions contained in your letter of February 20, 1987.

THE REDUCTION IN ASSISTANCE TO MINORITIES

The FY 1988 budget proposes the transfer of the Minority Business Development Agency (MBDA), now at Commerce, to the Small Business Administration. The transfer includes 140 full-time positions and $24,000,000 in grants for a total transfer of $35,798,000.

With the transfer of MBDA's management and technical assistance programs to the SBA, we expect a more direct, enhanced, and non-duplicative delivery of services to minority small business clients.

The proposal will build upon SBA's existing programs, strengthening the coordination and broadening the scope of minority business assistance while streamlining its delivery. The extensive network of MBDCs will provide SBA with a larger presence in minority communities where 83% of minority businesses are located.

Funding for the 7(j) program is proposed to be $4.8 million in FY 1988. These funds will be used to provide management training to minority businesses through trade associations. Other management and technical assistance will be provided through MBDCs.

The FY 1988 budget proposal does not request funding for the Business Development Expense (BDE) program. We believe that funding for BDE can be eliminated because of the increased availability of private capital needed by 8(a) firms to purchase equipment and the willingness of buying activities to award 8(a) contracts at a reasonable price.

THE ELIMINATION OF DIRECT LOANS TARGETED TO MINORITIES, HANDICAPPED AND VIETNAM AND DISABLED VETERANS

These reforms should not cause significant decreases in lending to minorities or to veterans. In 1986, ten percent of SBA loan dollars went to minority borrowers. Ninety-six percent of that total was delivered through the guaranty program. Only four percent came in the form of direct loans.

For loans to veterans, the picture is much the same. Veterans received twenty-two percent of SBA loan dollars, and ninety-six percent of those dollars came in the form of guaranteed loans.

Since guaranteed lending is such an overwhelming percentage of total lending to these groups, we do not believe that the termination of direct loans will have any substantial effect on their access to credit.

With respect to MESBIC, the budget proposes to begin funding MESBIC's through guaranty authority, rather than continuing the direct purchase of debentures with its inherent deep subsidy.

By doing this we will not only contribute to deficit reduction, but also bring MESBIC's into the mainstream.

The overall program level would remain close to current levels. The 1987 program level of $39 million would be reduced to $34 million in 1988, of which $20 million would be direct and $14 million guaranteed.

THE INCREASE IN FEES ON GUARANTEED LOANS AND THE REDUCTION IN THE PERCENTAGE OF GUARANTEES

Under existing law the guaranty percentages on 7(a) loans are these:

1. Not less than 90% on loans of $155,000 and under;

2. Between 70% and 85% on loans in the range between $155,000 and $714,285; and

3. Less then 70% on loans exceeding $714,285.

The proposed legislation would amend the Small Business Act to gradually reduce the existing participation percentage on loans guaranteed by this Agency in the following manner:

1988: Reduce from 85% to 80% the participation rate on loans in the range between $15,000 and $714,285

1990: Reduce from $155,000 to $100,000 the value on loans guaranteed at 90%

1992: All loans up to $714,285 would be approved at a participation rate of 75% or less.

Lowering the guaranty percentage will have two beneficial budgetary effects. First, it would lower program cost per dollar of loan, since SBA would be guaranteeing a smaller percentage against loss on each loan dollar. Second, a lower guaranty percentage should encourage more quality lending and lower loss rates. At the same time the level of Federal participation is significant enough to assure continued lending by private financial institutions to small businesses.

SBA has compared charge-off rates (charged off SBA amount divided by disbursed SBA amount) between loans with a 90% guaranty and those with a 70 - 80% guaranty. Loans in the latter category have charge off rates 16.3% lower than the 90% loans. This is consistent with the expectation that the lower the guaranty percentage the higher the loan quality, since the private sector lender is assuming more of the risk and will therefore make more careful loan approval decisions.

If we apply this percentage to the FY 1986 actual guarantee charge-offs of $308 million, this will translate to an annual savings to the Federal government of approximately $50 million in charged-off loans.

THE ELIMINATION OF SMALL BUSINESS DEVELOPMENT CENTERS

The Administration's budget does not propose the "elimination" of SBDCs, but rather, the gradual phase-out of the Federal role in SBDC funding.

This budget request provides a total of $31.1 million in resources for support of the currently established and operating Small Business Development Centers (SBDCs). Such centers are now located in 42 States, the District of Columbia, Puerto Rico and the Virgin Islands.

The Administration also proposes to phase out Federal funding for "matured" SBDCs over a three year period. We should remember that the original legislative intent was to stimulate creation of such Centers by Universities, by trade organizations and by other non-profit groups to meet the local small business training and business services needs.

The proposed five-year phase-out formula allows the programs that are at the start-up phase to continue to receive Federal funding through 1991 while phasing out the more mature programs within three years.

THE ELIMINATION OF THE POLLUTION CONTROL CONTRACT GUARANTEES PROGRAM

The Pollution Control Financing Guarantee Program was authorized in 1976 and began operation in 1977, for the purpose of assisting existing successful small businesses wanting to "prevent, reduce, abate or control noise, air, water pollution or disposal of solid or liquid waste." While 262 financings involving principal of some $360 million have been guaranteed to date, only 26 financings involving principal of some $53 million have been guaranteed since FY 1982. Most of the financings since inception of the program have benefitted small businesses in only six states. Further, although the program has charged substantial guarantee fees in accordance with legislative intent that it operate on a self-sustaining basis, significant losses from defaults have occurred, necessitating additional appropriated funds to pay guarantee claims.

Considering that the program's main financial vehicle, tax-exempt bonds, is severely curtailed by the 1986 Tax Reform Act, it is likely that new demand for financing under this program will continue to be low. It would appear that the basic need for a Federal program of this nature has been met, and that any subsequent demand that may arise can be met by the states involved and/or other SBA programs.

DENIAL OF TEMPORARY SHORT-TERM LOAN ASSISTANCE TO DISASTER VICTIMS WHO HAVE THE ABILITY TO OBTAIN FUNDS FROM OTHER SOURCES, AND INCREASED INTEREST RATES TO OTHERS

The budget also proposes to increase the interest rate charged on disaster loans from an artificially low, subsidized rate to a rate equal to that charged for direct loans in the Agency's regular business loan program (Section 7(a)), a rate comparable to the cost of money to the Government for existing loans of equal maturity at the time of the disaster, plus one percent to cover administrative expenses. Making the interest rate comparable to that of the cost of money to the government would still provide a subsidy to the borrower because the government gets better terms as a borrower to the pre-disaster condition, albeit with an additional debt burden. If the risk element were factored in, the applicable interest rate would probably be considerably higher than this proposal. The proposal would also have the effect of encouraging more applicants to use established private sector sources, like insurance, rather than relying on Federal funding.

NEW AND EXPANDED FEES

The FY 1988 Budget Proposal provides for an $88 million increase in existing user fees. Of this amount $68 million is from the Business Loan program as a result of increases in various guarantee and transaction fees; $8 million from the Surety Bond program for increases in surety and contractor fees; $5 million from the disaster loan program for the increase of the existing interest rate to the Treasury cost of money and $7 million from programs financed from the Salaries and Expense Fund. (APPENDIX VIII)

IMPLEMENTATION OF FY 1988 BUDGET PROPOSALS

I have attached to my statement (APPENDIX IX) a listing of major program changes contained in our FY 1988 budget proposal and the mechanism, legislative or administrative, needed to implement them. Those that require legislative change include the decrease in the percentage of SBIC guarantees, the elimination of the Pollution Control Financing Program, and changes in the fee structure under the General Business Loan Program.

This concludes the formal portion of my testimony. I would be pleased to answer your questions.

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SBA

Small Business Administration
Goals and Priorities
FY'87

October 15, 1986

U.S. GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Date: October 15, 1986

To: SBA Program Heads
SBA Regional Administrators

From: Acting Administrator

Subject: Agency Program Goals and Priorities for FY 1987

Attached is the compilation of program goals for FY 1987 for all Agency programs and administrative units. These goals have been developed over the past six weeks through a process of discussion and negotiation and have been distributed earlier in draft form to facilitate completion of Regional Action Plans and other operating plans. The attached compilation contains no substantive alterations from the version distributed on October 8 for program offices and October 14 for administrative offices.

I realize that you cannot fully implement your operating plans until I approve and disseminate the FY 1987 personnel ceiling and operating budget. Our operating budgets will be issued as soon as the Congress passes and the President signs a FY 1987 appropriations bill or Continuing Resolution.

Charles L. Heatherly

Small Business Administration

Agency Fiscal Year 1987 Goals and Priorities

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SMALL BUSINESS ADMINISTRATION

AGENCY FISCAL YEAR 1987 PROGRAM GOALS

An organization's goals and objectives can only be achieved by people not by regulations, SOP's, or "operating plans." Our priorities and objectives must first be clearly stated and understood by program heads; but more importantly, they must be translated into sensible and effective performance agreements. Therefore, I ask all the Agency's managers to give top priority to developing and completing performance plans for all employees according to the attached calendar.

It is the responsibility of Regional Administrators and District Directors to assure the full integration of the Administrator's Principles and Priorities and the Program Offices' program goals into their operating plans as well as SES and MAC plans in their respective areas.

Program goals and performance objectives for FY 1987 should be based on the following general principles and priorities:

I. GENERAL PRINCIPLES

1. Statutory and regulatory requirements are to be observed fully and conscientiously.
2. Service to the small business client is the touchstone for all agency activities.
3. Economy, efficiency and integrity in the use of agency resources are responsibilities of all employees.

II. AGENCY PRIORITIES

1. Productivity improvement in all program and administrative operations.
2. Improvement of internal control systems to safeguard resources and assets against waste, fraud and abuse.
3. Implementation of business development concepts throughout program offices to better focus available resources on demonstrated client business needs.
4. Expanded cooperation and coordination among all SBA units to focus Agency and private sector resources on improved portfolio management to achieve concrete, measurable progress in delinquencies and default rates, with regions and districts establishing specific goals founded on baseline data and unified efforts.
5. Cost recovery in program administration through user fees and other vehicles where authorized and appropriate.
6. Improved effectiveness in the 8a program through implementation of new regulations and emphasis on private sector markets.

III. PROGRAM GOALS FOR PROGRAM OFFICES

A. F & I Program Goals - Central Office:

Financial Assistance

1. Refine PLP guidelines and procedures to enhance program and increase its acceptability with participating lenders.

2. Review results of CICR reports to identify procedures and systems in need of revision or improvement to increase efficiency and effectiveness of staff resources.

3. Expand guidelines and provide continuing support to enhance full implementation of the Automated Collection System (DLCS) BY 9/30/87.

4. Study feasibility of expansion of centralized servicing concept both in home disaster loan and other SBA-serviced portfolios.

5. Using fiscal year end Field Office Evaluation System, identify a representative group of District Offices establishing the best and worst implementation of quality lending. Perform field reviews of representative loans from each to identify determinates of quality lending performance, and implement findings.

Investment Division

1. Consolidate productivity improvement begun during FY 1986 due to reallocation/reduction of human resources. Improve productivity further through implementation/refinement of paperwork reduction measures and use of computer systems developed or acquired over the past year. Convert all SBICs & MESBICs to new Form 468 financial reporting for reduced paperwork and improved financial data.

2. Improve program oversight and portfolio administration through increased use of financial trending and modeling with evaluation against peer performance and industry norms. Rotate personnel as appropriate for internal control purposes. Convert to use of ADP financial trend analysis on all SBIC leverage applications for over $1 million.

3. Pursue available options in each program for increasing private sector risk participation and cost recovery as appropriate. Subject to publication of final regulations, convert six of the largest SBG participating sureties to national agreement for better monitoring and risk participation.

4. Expand cooperation with and involvement of other SBA units and governmental agencies in program delivery administration as practical. Cooperate with BD in informing SBICs, sureties and pollution control financing recipients of available SBA management assistance and facilitating follow-up on activity generated.

5. Provide effective job-related training for staff members as needed and as available within budgetary constraints.

Disaster Assistance Division

1. Process 90 percent of applications to the point of approval (loan closing documents sent to applicant), withdrawal or decline within 60 days after filing of application.

2. Order checks for appropriate disbursements within 4 working days after receipt of necessary loan closing documents in 95% of the loan cases.

3. Continue implementing the detailed plan of action for improving DLM response to make operation simpler for applicant and more efficient for Agency, including improvements in communication, forms, procedures and outreach.

4. Improve productivity by renewed efforts to automate processes and emphasize loan officer training to accomplish quality lending goal.

Central Office accomplishments to be evaluated through quarterly progress reports to the AA/F&I.

A. F&I PROGRAM GOALS - FIELD OFFICES:

Financial Assistance

1. With usage of the Automated Collection System (DLCS) at approximately 30% of the District and Branch Offices currently, each Region shall attain a usage rate of 50% of their field offices by 3/31/87, 75% by 6/30/87, and full usage by 9/30/87.

2. Achieve specified National Business Loan Currency Rates (combined rates of all business loans and all disaster business loans) by 9/30/87. Listing below specifies regional rates in August 1986 MIS, together with the regional 1987 goal:

(Dollars in Millions)

REGION	8/30/86 Rate		Target Rate for FY 87	
	Number	Dollars	Number	Dollars
I	81.9%	80.7%	84%	83%
II	71.4%	71.0%	80%	80%
III	77.8%	74.1%	80%	80%
IV	81.3%	80.8%	83%	82%
V	72.7%	72.0%	80%	80%
VI	72.8%	70.8%	80%	80%
VII	80.2%	78.5%	82%	80%
VIII	77.9%	74.3%	80%	80%
IX	77.1%	76.9%	80%	80%
X	79.4%	76.9%	82%	80%
Agency	76.7%	75.3%	82%	80%

3. Achieve a net reduction in cases "In Liquidation" from 27,750 (August 1986 MIS) to 24,500 and in dollars from $2,221.2 to $2,000.0 by 9/30/87. The figures below represent specific regional targets:

(Dollars in Millions)

REGION	On Hand (8/31/86)		Goal (9/30/87)	
	Number	Dollars	Number	Dollars
I	1,212	91.2	1,050	82.0
II	4,220	194.2	3,500	175.0
III	1,503	129.4	1,300	117.0
IV	4,292	304.5	4,000	275.0
V	3,606	368.3	3,100	330.0
VI	4,311	370.6	4,000	334.0
VII	2,302	176.7	2,000	160.0
VIII	1,713	186.8	1,500	170.0
IX	3,518	270.2	3,000	243.0
X	1,081	114.3	1,000	103.0
Agency	27,750	2,221.2	24,500	2,000.0

Investment Division

1. Complete processing of 80% of Surety Bond Guarantee applications within 3 working days of receipt by SBA Regional Offices of applicants' complete submissions.

B. Office of Innovation, Research and Technology

1. Purge and evaluate for user fee the Pre-Solicitation Announcement mailing list (current list size 43,000).

2. Evaluate SBIR Program Phase III Commercialization data. To include technology trends, capitalization and companies' profiles.

3. Develop and implement leverage techniques and arrangements with State Governments to expand positive communications. (An example of this will be an effort to develop a cooperative effort with the Council of State Governments.)

4. Evaluate, redesign and implement outreach improvements in terms of maturity and future of the SBIR program. Analysis to include participating agencies, SBA regional needs, outside leveraged resources, and potential regional training.

5. Review program award trends as to States, awardee demographics and technology. Implement updated, simplified and standardized reporting from participating agencies.

C. Office of Procurement Assistance

(1) Increase small business share of prime contracts, subcontracts and Government sales through OPA programs and services.

A. Prime Contracts:

1. Through the FY 1987 goal-setting process, increase small business share of prime contracts by 2 percent (from FY 1986 base of 19.2 percent).

2. Develop business development resources to identify new small business sources, and to assist small businesses in the Federal marketplace at entry levels.

3. Complete the implementation of the systems breakout concept to enhance the opportunities for small business to obtain a share of formerly sole source and directed awards.

B. Subcontracting and PASS:

1. Through the FY 1987 goal-setting process, increase small business share of subcontracts by 5 percent (from FY 1986 base of 37.1 percent).

2. Review the portfolio of large business firms to determining where subcontracting opportunities exist.

3. Develop business development resources to assist small business in obtaining subcontracts through the development of workshops focused on subcontracting, individual counseling sessions, further development of the PASS and direct marketing to prime contractors.

4. Utilize PASS to obtain the most comprehensive listing of small business sources available so that Federal agencies and prime contractors are motivated to use the system on a routine basis.

C. Certificates of Competency:

1. Reduce the delinquency rate of the COC program by better analysis of a firm's capability before issuing a COC.

2. Reduce the delinquency rate of the COC program by more structured and routine monitoring of firms in COC portfolio.

3. Reduce the number of firms applying for multiple or continuing COCs through the imposition of application fees for COC processing.

(2) Improve the technical capability of OPA personnel through training and performance monitoring by ARAs, RAs, and Central Office staff.

(3) Develop linkages between OPA, MSB/COD, OWBO, OVA, and OBD to ensure that all segment of the small business community receive equal benefit from OPA programs and services. Improve existing linkages to better reflect client needs.

(4) Conduct comprehensive review of size standard policy and procedures in cooperation with the National Advisory Council Task Force to develop new regulations on size standards to meet perennial criticism of Agency by Congress, small business groups, and the public.

D. Special Programs

Business Development

1. Monitor and evaluate needs analyses by trade organizations such as NFIB, U.S. Chamber, NSBU, academic groups and State and local entities. Examine relevant data from MIS and other SBA resources to determine how such data can be better interpreted and used to determine program priorities.

2. Work closely with responsible SBA evaluation offices to assure an effective impact measurement system to capture data needed by the Office of Business Development. BD participation in this process will occur through SBA's annual Program Evaluation Plan, which will be established in FY 1987.

3. Organize and staff a marketing office to develop and disseminate standard and focused outreach procedures and materials for guidance of field offices in all outreach activities. Part of this guidance will be to ensure cost efficient outreach operations for all offices and programs.

4. Implement a training program for BD personnel to accelerate the transition in role from providing direct services to small business clients, to developers and managers of resources. Special emphasis on developing partnerships with non-governmental entities capable of meeting the needs of Small Business.

5. Technical Assistance:

   a. Assist SBA program directors in applying Business Development principles in their program areas at all levels of the Agency. Draft procedures for consideration by program directors.

   b. Implement the Computer Internal Control Review (CICR) System within BD.

   c. To improve coordination among BD and Special Program Offices, develop and maintain a national master calendar of events such as meetings and conferences. This function will be coordinated by the BD Marketing Office. Special Programs Offices will supply current information.

d. Ensure that the full range of resources available through the BD network is incorporated into the 8(a) program as needed. A BD/MSB intra-agency agreement will formalize this process.

6. Resource Management

   a. Aggressively recruit SCORE volunteers based on a systematic assessment of training and counselling needs. Newly recruited SCORE volunteers will be assigned activities related to their expertise and talents. Establish recruitment targets in coordination with district offices.

   b. Improve the scope and quality of SBA mailing lists to increase effectiveness of outreach efforts.

   c. Obtain approval from OMB and issue Regulations for the SBDC program to improve internal control systems and overall management effectiveness.

   d. Examine the various oversight activities of the SBDC program to determine areas of overlap or duplication. Based on this examination, develop an efficient and effective oversight program.

   e. Establish seven new Small Business Development Centers to expand outreach to those States not currently represented.

   f. Continue to examine the feasibility and potential organization of a clearinghouse for information exchange among SBDC's to ensure that individual SBDCs are aware of significant successes or failures of other SBDCs. Incorporate these experiences as guidance in SBDC program development efforts.

   g. Expand private sector, for-profit involvement in SBDC operations wherever possible.

7. Private Sector Involvement:

   In each field office, facilitate and assist all SBA offices in efforts to substantially increase participation of for-profit organizations in SBA programs above fiscal year 1986 levels.

8. Cost Recovery:

   Establish the policy and procedures for application of user fees in all services to achieve greater cost-recovery where authorized and appropriate.

9. Implement the Business Development SOP:

Office of Veterans Affairs

1. CENTRAL OFFICE GOALS:

    a. Develop or sponsor program tapes for blinded veterans at "lighthouse" libraries or local government locations.

    b. Update and improve veterans program exhibits used at conventions and major conferences/seminars.

    c. Use and contribute to the BD/SP calendar of activities in planning and managing OVA outreach.

    d. Work with the Office of Advocacy to establish a "Veterans Hotline" to communicate our program and respond to inquiries. This effort will be coordinated with veterans organizations that would help underwrite hiring disabled veterans to staff the hotline service.

    e. Continue subsidizing the Bell Atlantic program for veteran participants.

2. FIELD OFFICE GOALS:

    a. In Fiscal Year 1987, one pilot procurement conference will be conducted to test assumptions concerning the need for this service. Implementation of 5 other conferences will depend upon the pilot. Our goal will be to have a minimum of 300 veterans at each conference.

    b. Implement in selected areas of the country a minimum of six educational programs for veterans based on the South Carolina project.

    c. Implement a special program directed toward catastrophically handicapped veterans. The program goal will be to assist those who could operate from their home or are unaware of the opportunities available to them in the business community. (These are wheelchair-bound veterans who are restricted at the various Veteran's Administration Hospital Vocational Rehabilitation Centers.)

Office of Women's Business Ownership

1. CENTRAL OFFICE GOALS:

   a. Obtain private sector support for national conferences including financial co-sponsorship, agenda development, panel members and moderators. These national conferences will be done in cooperation with OPSI and will aim at maximum feasible cost recovery.

   b. Establish a clearinghouse to match private sector companies to specific projects appropriate for their support and aimed at women-owned businesses. The objective is to increase private sector sponsorship of OWBO.

   c. Conduct a training session for all WBO Coordinators on improved outreach, resource management and program planning.

2. FIELD OFFICE GOALS:

   a. Conferences for women business owners have offered training in starting a business. In response to the need for attention on business expansion, a national series focusing on expansion will be implemented. One conference in each region will be conducted, with each having two components: (A) moving from home to the marketplace; (B) workshops for the business that is at least 3 years old and grossing over $1 million in revenues. The latter workshops will focus on establishing satellite operations, and merger and acquisition.

   b. Conduct a series of financial planning conferences, one in each region, that will assist women business owners in operating their businesses with greater success.

   c. Improve communications in all offices between WBO coordinators and SCORE/ACE volunteers through press releases and public service announcements.

   d. Improve communications among women business owner organizations to establish national priorities and to assist in moving their respective membership to the general business stream. Communications plan will emphasize alliance building with local and national organizations, such as Greater Board of Trade in Washington, D.C., the U.S. Chamber of Commerce, and major professional and trade organizations.

Office of Private Sector Initiatives

1. CENTRAL OFFICE GOALS:

   a. Serve as a resource to the Agency's Central and Field Offices program areas in the following ways:

      1. bringing innovative concepts to the attention of management and determining SBA program feasibility;

      2. assisting in locating for-profit support for national program initiatives identified by management.

   b. Work directly with the Office of Advocacy, including outreach to the NFIB, the U.S. Chamber of Commerce, and other trade associations, to co-sponsor a series of tax reform seminars focusing on small business issues. Private sector support is being negotiated.

   c. Negotiate all private sector co-sponsorship agreements based on at least three separate offers by the private sector for the benefit of the Agency and the small business community.

   d. Develop and maintain a list of national private sector resources for co-sponsorship.

2. FIELD OFFICE GOALS:

   a. Train District Office program employees, including training in negotiation, on how to effectively seek and obtain private sector support.

   b. Develop and maintain a list, by subject area and region, of local private sector resources for co-sponsorship.

   c. Report regularly to Central office on field activities which have utilized private sector resources for support. This will include a description of the event, a "best efforts" statement regarding negotiation with the private sector resource, a copy of the signed agreement, and a brief cost/benefit analysis.

Office of International Trade

1. CENTRAL OFFICE GOALS:

a. The Office of International trade will develop an outreach program to those small business entities that have the capability to exporting but have not entered the international trade market. The program will identify such firms and provide an educational package to assist those interested in obtaining the necessary information and support for expansion into the international trade arena.

2. FIELD OFFICE GOALS:

a. The Office of International Trade will develop an FY '87 operational plan for Fiscal Year 87 which will include use of the Department of Commerce data base and the SBA field network to implement an outreach program to those firms identified above. The plan will include specific actions to be negotiated with BD to incorporate BD outreach resources.

b. OIT will negotiate action plans with Regional and District Offices leading to development of a resource network of public and private organizations that can support international trade programs for small business.

c. OIT will take the lead in encouraging and assisting the network developed in (b) above to develop a clearinghouse of publications and services available to small business on international trade. This activity will aim at institutionalizing a diverse data base to make it accessible to all small businesses wishing to export.

d. OIT will assist Regional and District Offices to develop a marketing/outreach program to assure adequate dissemination of the publications, services, and programs available to small business in the international trade area.

E. Minority Small Business & Capital Ownership Development

1. Insure that 7(j) management and technical assistance is provided to eligible small businesses through effective, efficient management and that appropriate internal controls are utilized to safeguard against fraud, waste and abuse.

   a. More definitive procedures are being developed by the Central Office for the 7(j) unsolicited and cooperative agreement process. An "area of interest" plan for unsolicited proposals will be developed so that unsolicited awards will be more consistent with program goals.

   b. Field Offices will survey the clients' needs for general and specialized 7(j) management and technical assistance services and develop a program announcement based on those needs. Alternatives to 7(j) assistance, such as Business Development resources, should be explored as a means of providing effective management and technical assistance at the lowest possible cost to the government.

   c. Section 7(j) report evaluations will be made by Central Office and field offices to determine if requested management and technical assistance services have been beneficial to the client.

   d. The computerized internal control review (CICR) process will be refined more effectively monitoring of the 7(j) process.

2. Establish and adhere to processing time frames for 8(a) applications, termination actions and fixed program participation extension requests.

   SOP 80-05 currently reflects time frames established for processing 8(a) applications. Time frames are to be developed for termination actions and fixed program participation extension requests. Field Offices will prioritize and balance work assignments to meet processing time frames.

3. Implement an improved system for informing Federal executive branch personnel (program, contracting and office of small and disadvantaged business utilization staff) of 8(a) program policies, procedures and changes.

   a. A manual will be developed and provided to Federal buying activities explaining how to contract with SBA under Section 8(a) of the Small Business Act.

   b. Periodic visits to these activities will be made to promote and explain the 8(a) program in pursuit of an increased number and dollar amount of 8(a) contracts. This promotion will occur at both Central and Field Office levels.

4. Establish and adhere to processing time frames for acceptance or rejection of requirement offerings received from Federal buying activities.

   a. More definitive procedures will be developed by the Central Office for acceptance or rejection of the requirement offerings received from Federal buying activities.

   b. Local buy requirements that cannot be matched in one region will be forwarded to other regions before any rejection by the Agency.

   c. The computerized internal control review (CICR) instrument will be revised to monitor adherence to establish time frames.

5. Insure that 8(a) concerns in the transition stage (last 2 years of the original FPPT) receive concentrated management and technical assistance and non-8(a) marketing support.

   a. MSB/COD will work closely with the Office of Business Development to develop strategies for utilizing BD resources to assist transitioning 8(a) firms.

   b. A similar working relationship will be established with the Minority Business Development Agency (MBDA) to determine how MBDA resources can be used to assist transition firms.

6. Work with the SBA National Advisory Council and private sector groups to expand agency utilization of outside expertise and resources in developing program priorities and improving the effectiveness of all program services.

F. Advocacy Program

1. Provide information and advice to the Administration and Congress regarding appropriate follow-up to the White House Conference on Small Business. The office will give particular attention to liability reform, health and pension benefits, direct government and indirect non-profit competition, international trade policy issues, labor laws including Davis-Bacon Act, strengthening of the Regulatory Flexibility Act and monitoring implementation of new tax reform laws and regulations.

2. Inform and improve the understanding of the public and the government on the role small business plays in the economy and the small business ramifications of government policy decisions. Key emphases will be:

   (a) Publication of the President's Annual Small Business Report in spring, 1987.

   (b) Expanded use of SBA data base and research product outside of Small Business Administration--in government, academe and the private sector.

   (c) Conducting a quality research program with products disseminated in a timely manner to appropriate audiences.

3. Improve cooperation and communication with other SBA programs and with other branches and agencies of government whose decisions significantly affect small businesses:

   (a) Earlier and more consistent liaison with Federal agencies at the national and regional levels to emphasize the consideration of small business impacts before policy, regulatory and programmatic decisions are made.

   (b) Increased attention to State and local government levels where SBA Advocacy can provide policy information important to the local small business environment.

   (c) More effective coordination with SBA programs at the Central Office and field levels to better inform Advocacy's analysis of small business policy questions, and to utilize Advocacy experience on program issues.

4. Provide leadership to the small business community in researching and discussing those policy issues which may affect the business environment in the future.

IV. PROGRAM GOALS FOR ADMINISTRATIVE & STAFF OFFICES

G. Office of General Counsel:

1. Provide sound legal counsel in support of Administrator's initiatives, such as the NAC Task Forces, the User Fee Policy Group, and the Agency's FY '88 Legislative Agenda.

2. Increase the rate of closing claims litigation cases. (Indicator: not less than 20% of cases on hand at the beginning of each quarter will be closed during the quarterly period).

3. Ensure that quality counseling services are extended to all programs and administrative operations conducted within the Agency.

4. Arrange training sessions for appropriate office personnel whenever new laws, regulations and policies have been issued which significantly change programs and/or administrative operations. Arrangements for such sessions should be approved by the office director.

5. Take an active role in local bar activities and attend at least two legal seminars related to career development during the course of the fiscal year.

6. In cooperation with the Regional Counsel and the Associate General Counsel for Litigation, establish, as budget permits, the computer technology to install a litigation tracking system.

H. Office of Public Communications

1. Complete and finalize for Agency approval and Congressional review the reorganization of the office to effect improved program management, efficiency and control through recruitment and employee professional development efforts.

   A. Pending necessary approvals, informally establish Office of News Services, Office of Creative Services and Office of Field Services as working, operational units of the Office of Public Communications.

   B. Professionalize speech writing capability for the Office of the Administrator and extend service to the Management Council. Identify and prioritize audiences and speaking engagements.

   C. Identify national and regional media interview opportunities and establish schedule and target dates for Administrator. Identify and correlate specialized media opportunities for specific program managers' areas of responsibility and expertise.

2. Modify and redirect program functions to create communication development capabilities to be used in support of individual SBA program objectives and Agency initiatives in general.

   A. Identify and evaluate current and prospective target audiences important to the Agency overall and to the program areas in particular. Prioritize and computerize target audience listing.

   B. Develop public relations campaign emphasizing program improvements resulting from new 8(a) regulations. (Provide national, regional and local communications material).

   C. Intensify communication efforts about improved initiatives in portfolio management, debt collection, loan asset sales, and private sector lending programs.

   D. Provide all program areas with professional communications and marketing support for specific projects and programs.

   E. Complete computerization of graphics function to provide Agency-wide service for both audio-visual needs and typesetting to reduce costs incurred through outside contracts.

3. Develop, execute and sustain an aggressive public communications campaign to inform and educate the general public about the contribution and value of the small business community to the economic health of the nation.

   A. Coordinate and expand positive public information campaign in support of Small Business Week.

   B. Provide all Field Offices with a public communications guide containing promotional material for small businesses.

   C. Increase media understanding and use of Advocacy's economic data and special studies.

I. Office of Hearings and Appeals

1. Increase the frequency of preparation and distribution of OHA decision digests for use by agency counsel, program officials and the public.

2. Consistent with budgetary constraints, upgrade the WANG capability to research OHA precedents, including, if feasible, on-line access by OHA regions.

3. Optimize opportunity to obtain career development training in areas relevant to decisional responsibilities, e.g., accounting, corporate organization, FOIA/PA, participation in professional activities.

4. Increase participation in inter-agency efforts consistent with Administration priorities, e.g., participation in study by Administrative Conference of Debt Collection Act implementation.

5. To provide FOIA/PA training to Central Office program managers and staff concerning current judicial decisions, Department of Justice directives, and SBA policy developments.

6. Foster opportunity for OHA administrative judges to meet in a structured program with agency program managers, including regional officials, responsible for size determinations.

J. Office of Inspector General

1. Annually audit the over 500 Small Business Investment Companies as required by the Small Business Investment Act of 1958.

2. Increase non-SBIC activity with existing staff by at least 14 audits.

3. Achieve 100% increase in dollar accomplishments realized as a result of management's actions in response to audit findings and recommendations, over those for FY 1986.

4. Revise the Agency regulation to permit substantially increased collection of audit fees from SBICs consistent with our costs and in accordance with the Act. Currently, these collections amount to about $1 million annually. Increase collections by at least $250,000 per year from an increased fee schedule.

5. Propose revision to the Small Business Administration Act requiring independent public accountants of the SBIC to accomplish the compliance audit of the SBIC. This change would enable use of audit resources on other areas which are not receiving appropriate audit coverage.

6. Respond timely to all requests for contract, grant and cooperative agreements audits.

7. Complete the annual Internal Audit Plan. This plan will include three audits of the 8(a) program, i.e. advance payments, business development expenses and program completion dates.

8. Implement full office automation of all Central Office Duty Stations.

9. Provide Special Agents with increased training in modern criminal investigative techniques.

10. Select cases for investigation that have a high probability of resulting in an indictment, conviction, administrative action, and/or dollar recovery.

11. Reorganize Central Office operations to clearly designate managerial responsibilities.

12. Initiate a quality assurance program to evaluate the efficiency and effectiveness of investigative operations.

13. Develop and issue an Investigators Handbook that clearly defines investigative procedures.

14. Reduce the average time to complete investigations.

15. Give maximum priority to investigations concerning employee integrity.

16. Improve the Office of Inspector General's internal controls and management by "peer reviews" of selective duty stations. Increase overview of field operations through increased field visits by central office supervisors.

17. Conduct timely, coordinated and effective reviews of all significant Agency legislative, regulatory and other policy and procedural initiatives.

18. Revise and/or develop policies and procedures affecting significant OIG operations.

19. Improve effectiveness of OIG Freedom of Information/Privacy Act processing.

K. Office of Congressional and Legislative Affairs

1. Using provisions of the FY '87 Appropriation and Reconciliation bills and President Reagan's FY '88 Budget proposal initiatives as a base, coordinate with the Office of Legislation in OGC and with SBA program heads to develop an agency Legislative Agenda including drafting of necessary legislation for consideration by the 100th Congress.

2. Once drafted and cleared by OMB, work for the introduction and passage of such legislation.

3. Review and prepare recommendations for Administrator and OMB on all Congressionally initiated legislation related to SBA and the small business community. Work with appropriate Congressional Committee staffs to resolve problems and improve such legislation.

4. Continue efforts to improve timeliness and responsiveness to Congressional casework inquiries.

5. Continue efforts to improve the productivity and efficiency of CLA staff while expanding the quality of services provided to agency executives and program heads.

6. Establish an efficient CLA system for tracking Agency actions prescribed by legislation and other Congressional requirements, e.g., conference or committee reports, to assure timely delivery and full compliance.

L. Management and Administration

Office of Information Resources Management

1. Provide reliable, timely service and accurate information to all users of SBA's automated office and Automatic Data Processing (ADP) management information systems.

2. Develop a five-year IRM Plan to predict and meet SBA's expanding ADP and office automation information needs with state-of-the-art hardware, software, telecommunications, and training.

3. Prepare comprehensive work plans, requests for proposals, and statements of work with controls to ensure timely delivery of quality products.

4. Implement automated office concepts throughout SBA to improve productivity, morale, and credibility.

5. Facilitate cooperation and coordination among all SBA units and encourage integration of smaller fragmented subsystems into a comprehensive database.

Office of Administration

1. Cut space costs by reducing average utilization rate. Maintain U/R statistics based on actual space and supplemental space definitions from GSA. Institutionalize space reductions through issuance of SOP 00 15. Continue to refine layouts and space utilization through training of field staff, liaison visits, systems furniture, and CAD.

2. Continue the procurement career program with vigor. CO training will be emphasized. The Career Board will work toward automating and institutionalizing the standards and procedures of the Career Program relating to individual qualification, the SOP and determining if special recruitment and performance evaluation criteria and activities should be tailored to the procurement career field in SBA.

3. Cut costs in mail, distribution, and facsimile management. High cost mail such as DHL and Express Mail, as well as lengthy facsimile transmissions, have become routine rather than exceptional. Keep program offices informed of their mail expenditures. Develop a process for analyzing mailings to ensure mail is sent at the lowest possible rates. Centralized mail service contracts, metered mail and other means to reduce cost will be aggressively pursued.

4. Provide training in mail and facilities management. Central Office will work with the Office of Personnel and other organizations to identify practical job-related training. Regions will continue to take advantage of local GSA and OPM training, where effective.

5. Maintain effective labor management relations. Central Office will continue to work with the Field and management officials to assure prompt and effective response to union issues. Communications representing management's position will continue. Begin preparations for possible contract reopening at the end of FY 87. The field should continue to maintain their labor management team, keep current on labor management trends, and respond effectively to labor management issues when raised.

6. Establish field directives system -- reduce forms and reports. Individual discussions will be held with the Regions to develop a Plan of Action in each Region where a Directives System is not present, or to improve systems already in place. The AA/A will make on-site visits to meet with appropriate staff including the RA, to gain the necessary support. Central Office will continue its offer to come on-site and help Regions establish systems. The Quality Circle will continue its efforts in forms and reports reduction as a companion effort to the Regional Directives System.

7. Provide better contract support for agency's ADP needs. Develop guidance to support more effective procurement of ADP equipment. Regional offices should issue appropriate direction to their districts and branches for consistent, effective, and efficient acquisition of ADP equipment.

8. Improve 7(j) and SBDC processes. Continue team building efforts to improve relationship between OPGM and program staffs. Encourage new ways to team with the field. Develop more definitive guidelines, especially for the 7(j) unsolicited and competitive cooperative agreement processes. Administration will join the MSB monthly conference call to insure that any 7(j) issues are dealt with effectively and promptly. Be alert to methods of increasing effectiveness while lowering cost, particularly procedural streamlining from application phase to award.

9. Support administration's initiative to reduce FTS and long-distance telephone abuses. Maintain current SOP and disseminate cautionary posters. Conduct active review and referral of telephone bill details.

Office of Personnel

1. Implement a plan to ensure the timely and accurate processing of personnel actions in accordance with established time standards and statutory and regulatory requirements.

2. Develop and implement a training program that builds employees' skills for fully successful performance and improved productivity and also enhances recruitment and retention of high achievers.

3. Utilize the capabilities of the Personnel Data System in developing and issuing a full range of personnel management information and control reports that allow for tracking quality measures of servicing personnel programs; respond immediately, specifically, and effectively to identified problem areas.

4. Establish and promote a suggestion program that results in improved quality, efficiency, and effectiveness of work methods, products, and procedures.

5. Develop and implement specific, localized recruitment programs that will identify and attract a sufficient number of highly qualified applicants for advertised vacancies, including those eligible to be appointed under special employment/emphasis program authorities.

6. Improve the use of performance systems as management tools by effectively linking performance with other personnel decisions; providing for consistency in the rating process; providing for substantive recognition for outstanding performance; and communicating to supervisors the need for fair and accurate ratings.

Office of Equal Employment Opportunity and Compliance

1. Provide EEO training to managers and supervisors in Regional Offices to clarify the role of EEO and to generally improve the image of the program.

2. Provide EEO training for EEO officials in Regional/District Offices and the Central Office to improve their overall effectiveness and quality of services provided .

3. Expand the expertise and efficiency of the Civil Rights Compliance staff to provide better service to the Agency and to the small business community.

Office of Program Analysis and Review

1. Coordinate the implementation of the Agency's Productivity Improvement Plan to meet the President's goal of a 20% productivity improvement by 1992. OPAR will chair the Productivity Improvement Steering Committee charged with the responsibility of developing productivity initiatives.

2. Direct, execute and monitor the SBA Computerized Internal Control Review (CICR) system to ensure a prompt, results-oriented measure of field office compliance with internal controls designated to safeguard resources and assets against waste, fraud and abuse.

3. Work closely with the Office of Business Development to ensure that Computerized Internal Control Review (CICR) checklist items, designed to measure field office compliance with business development concepts, are developed and integrated into the CICR system.

4. Work closely with the Central Office officials involved to ensure that appropriate CICR sections are revised to evaluate cooperation and coordination among field office units in addressing improved portfolio management.

5. Work closely with the Office of Minority Small Business and Capital Ownership Development to ensure that new 8(a) regulations are translated into CICR checklist items and integrated into the CICR system to measure field office compliance with the regulations.

6. Provide staff support for Administrator's User Fee Policy Group, established to develop specific recommendations to the Administrator for new or revised user fees within Agency programs.

Office of the Comptroller

The Comptroller's Office will continue its administrative support of the Agency's programs and goals through efforts to streamline operations, provide more efficient and effective systems and improve internal controls:

1. Continue efforts to establish tighter fund controls on the loan funds, surety bond funds and administrative funds. We have currently established a funds control system for all Business Loans and for the Surety Bond fund through the computerized network. This will eliminate any possibility of over-obligation and provide internal control on a regular/daily basis.

2. Develop the specifications for the automation of the funding control system for the Disaster loan programs. The Office of Information Resources Management is also currently reviewing existing systems utilized in the funding processes of this program. It is expected that actual design and programming for the Disaster funds control system will begin in January 1987, will be tested during the spring and summer, and will be ready for full implementation on October 1, 1987.

3. Develop specifications and obtain design confirmation by end of FY '87 for an improved administrative accounting system to provide on-line certification of funds availability and on-line data entry and query functions. The system will enable commitment monitoring and will interface with other SBA subsystems: procurement, invoice and receivables tracking, administrative property and travel.

4. Review the possibility of direct on-line processing, by the Field Offices, of all guaranteed purchases and the recording of miscellaneous receipts through the Agency's computerized network system. Specifications are in draft form and must be submitted to GAO for approval. Upon approval we anticipate expediting the delivery process, eliminating or reducing the number of documents from within the system, eliminating interest penalty payments, providing on-line query capability and speeding the delivery of checks to the payee.

   The goal is to have on-line guaranteed purchases completely automated by September 30, 1987 and miscellaneous receipts automated by March 31, 1988.

5. In support of Agency-wide productivity improvement efforts the Comptroller's Office will continue to support all of the various financial systems improvements, such as (1) streamlining the disbursement processing of loan checks and (2) improving the collection process to the extent possible through "same day system update as received by the Office of Financial Operations (Denver)."

6. The Comptroller's Office will support the "user fees" programs by (1) establishing proprietary accounts through the Department of Treasury upon authorization, (2) developing and coordinating appropriate accounting and collection systems, and (3) developing and implementing the necessary reporting mechanisms.

APPENDIX II

SMALL BUSINESS ADMINISTRATION

SBA NOTICE

TO: Management Committee

NOTICE NO. 2000-106

EFFECTIVE 11/4/86

SUBJECT: FY 1987 Ceiling Adjustments

The enclosed ceiling Allocation Control, SBA Form 847, reflects your revised ceilings, effective immediately. Operating budgets will be adjusted at the end of the first quarter to reflect funding for the adjusted ceilings, provide full year funding for temporary positions and additional funding for the pay raise that goes into effect in January.

Enclosed is a summary of all the additional positions that have been allocated to the regions. This represents your efforts in trying to more equitably distribute resources.

Finally, I must again emphasize the importance of remaining within your total ceiling allocation and corresponding operating budgets, and the seriousness of any anti-deficiency violation.

Your cooperation in this matter will be greatly appreciated. If you have any questions, please feel free to contact me or Mr. Rosenthal.

Lawrence R. Rosenbaum
Acting Comptroller

Enclosure

EXPIRES 2/1/87

CENTRAL OFFICE PERMANENT POSITIONS
AS OF NOVEMBER 3, 1986

	On-Board	Ceilings	
	9/30/86	Current	Revised
Executive Direction	23	22	25
Size Standards Staff	6	5	6
Inspector General	118	127	135
Central Office	43		
P.O.D.	75		
General Counsel	32	33	35
Public Communications	15	17	20
Congressional & Legislative Affairs	11	12	12
Advocacy	24	23	24
Hearings & Appeals	18	18	18
Finance & Investment	96	95	102
Procurement Assistance	32	30	34
Central Office	27	25	
P.O.D.	5	5	
MSB-COD	31	34	35
Innovation, Research & Technology	9	9	9
Business Development	33	38	37
Private Sector Initiatives	5	5	5
International Trade	4	4	4
National Advisory Councils	4	3	4
Comptroller	133	137	145
Central Office	75		
P.O.D.	58		
Administration	70	70	70
Personnel	39	38	40
Information Resources Management	74	83	90
Program Analysis and Review	18	15	25
EEO&C	36	36	36
Central Office	13		
P.O.D.	23		
Total	831	854	911
Central Office	670		
Post-of-Duty	161		

ADDITIONAL FIELD CEILING POSITIONS
AS OF NOVEMBER 3, 1986

	I	II	III	IV	V	VI	VII	VIII	IX	X	Total
Procurement Assistance	-	3	13	2	6	-	-	-	6	-	30
Systems PCR's	-	2	10	2	5	-	-	-	2	-	21
Traditional PCR's	-	1	2	-	1	-	-	-	1	-	5
COC Specialists	-	-	1	-	-	-	-	-	3	-	4
Business Development	1	1	1	1	1	1	1	1	1	1	10
Veteran Assistance Offices	1	1	1	1	1	1	1	1	1	1	10
Finance & Investment	2	4	2	11	3	8	11	3	12	4	60
Portfolio Management	1	1	1	7	-	5	5	2	4	-	26
Financial Assistance	1	1	1	3	2	1	4	-	5	2	20
Surety Bond	-	1	-	-	1	1	2	1	2	2	10
Disaster Servicing Center	-	1	-	1	-	1	-	-	1	-	4
General Counsel	2	1	4	-	-	-	-	-	-	1	8
Litigation	2	1	4	-	-	-	-	-	-	1	8
MSB/COD	-	-	4	2	-	2	-	-	3	-	11
Executive Dir. & Field Admin. 1/	3	2	1	3	2	3	1	2	1	2	20
Total	8	11	25	19	12	14	13	6	23	8	139

1/ These positions are considered discretionary and can be used for other program requirements.

SBA Final and Proposed Regulations for 1986

I. FINAL RULES

A. Small Business Size Standards

1. Engineering, architectural and surveying services 8/4/86 51 F.R. 20795
2. Time of Size Determination for Sec. 8(a) Program 12/17/86 51 F.R. 451022. (Interim rule with request for comments: 4/7/86 51 F.R. 11705)
3. Wholesale trade 7/11/86 51 F.R. 25189
4. Dredging 12/8/86 51 F.R. 44036

B. Business Loan Policy

1. Raising guarantee fee from 1 to 2 percent; increasing the portion which SBA must guarantee at 90 percent from $100,000 to $155,000; and lowering from 90 percent to 85 percent the maximum SBA guarantee for loans over $155,000. 5/20/86 51 F.R. 18436
2. Elimination of exception to media policy rule for cable TV systems, commercial radio and television broadcasters. 3/26/86 51 F.R. 10362
3. Homestead protection for farmers and ranchers in SBA foreclosure actions. 5/8/86 51 F. R. 17002

C. Disaster Loans

1. Implementation of statutory withdrawal of SBA's authority to make physical disaster loans to agricultural enterprises and establishment of the size standard for agricultural enterprises as "not in excess of $500,000 in annual receipts. 9/10/86 51 F.R. 32197

2. Deletion of Appendix A (Interest Rates in Effect Prior to 1982) to Part 123 12/31/86 51 F.R. 47209

3. Elimination of SBA authority to make disaster loans of any kind to agricultural enterprises or to any entity in response to currency fluctuations or to Federal action. 12/18/86 51 F.R. 45299

D. Debt Collection
Rule establishing procedures SBA will use in referring deliquent borrowers to IRS for offset of their debt against any income tax refund they may be entitled to. 11/25/86 51 F.R. 42547

E. Loans to State And Local Development Companies

1. Revision of rules for development companies certified under section 503 of the Small Business Investment Act of 1958. 6/6/86 51 F.R. 20764

2. Establishment of a 2 year pilot program where debentures guaranteed under section 503 of the Small Business Investment Act are sold to investors through public sale or private placement. 6/6/86 51 F. R. 20781

F. Section 8 (a) Program
Complete revision of program regulations 10/8/86 51 F.R. 36132

G. SBA Organization/ Delegations of Authority

1. Authority of Inspector General to use SBA seal. 4/22/86 51 F. R. 14979

2. Delegation of authority to Washington District Director of unlimited 8(a) contracting authority by removing the requirement of a certificate of appointment to purchase goods or services or to enter into 8(a) contracts above a certain dollar amount. 10/6/86 51 F. R. 35501

3. Delegation of Authority 2/7/86 51 F.R. 4703

4. Delegation increasing authority of Regional Administrators to approve applications of Certificates of Competency (COC) from $2,000,000 to $5,000,000 and to allow the Regional Office COC Specialist to approve COC cases that are valued at less than $250,000. 12/8/86 51 F.R. 44036 (Transferred from Part 125.5 to Part 101.3: 12/8/86 51 F.R. 44037)

5. Standards of Conduct Counselor Transfer of duties to Deputy General Counsel. 3/5/86 51 F. R. 7550

H. Pollution Control Bond Guarantee Program Eligibility policy: changed to make ineligible waste disposal concerns (trash haulers)for pollution control bond guarantees. (Proposed rule: 1/9/86 51 F.R. 996; correction: 2/14/86 51 F. R. 5543) Final Rule: 6/4/86 51 F.R. 20247.

I. Small Business Investment Companies(SBICs)

1. Accounting standards and financial reporting requirements. 8/28/86 51 F. R. 30750.

2. Establishment of system to finance SBICs by selling to the public certificates of interest backed by trusts or pools of SBA guaranteed debentures and removal of authority of the Federal Financing Bank to purchase debentures issued by SBICs. 6/12/86 51 F.R. 21484 (Technical change: substitution of "debenture rate" for "Federal Financing Bank rate". 11/4/86 51 F.R. 4000.)

J. Surety Bond Guarantee Program

1. Amends Part 115 to lower the maximum guaranty for surety losses resulting from the breach of the conditions of a bond from 90 percent to 80 percent, to increase the maximum premium that a surety may charge a small concern from 1.5 percent to 1.8 percent, and to raise SBA's guarantee fee from $5 per thousand of contract amount to $6 per thousand. 6/9/86 51 F. R. 20922 (Policy statement regarding the decrease of guaranty with request for comments: 2/4/86 51 F. R. 4297. Delay in effective date of policy statement: 3/26/86 51 F.R. 10362)

2. Increase amounts that SBA may guarantee from $1,000,000 to $1,250,000. 7/30/86 51 F. R. 27166 (Correction: 51 F. R. 27167)

B. PROPOSED RULES

a. Establishment of guidelines for the Breakout Center Procurement Center Representative Program 6/27/86 51 F.R. 23426 (Extension of comment period from 30 days to 60 days: 7/30/86 51 F.R. 27194) Decision by Program not to proceed to Final Rule: 10/86.

b. Comprehensive regulations covering programmatic and financial aspects of the Small Business Development Center Program. 10/23/86 51 F. R. 37580 (Comment period extended from 60 to 90 days: 12/24/86 51 F. R. 42255)

c. Small Business Size Standards

1. Travel agent industry 7/30/86 51 F. R. 27192

2. Shipbuilding and ship repair 2/28/86 51 F. R. 7077 (Correction: 5/1/86 51 F. R. 16176.)

SALE OF DEVELOPMENT COMPANY AND SBIC DEBENTURES

504 Pilot Program

SBA began approving 504 debentures on July 1, 1986. From July 1 through December 31, 1986, 851 debentures totaling $192 million were approved under this program. When projects are completed, debentures are pooled according to term and pass through Certificates evidencing ownership to the pool are sold. 195 debentures totaling $41.7 million have been funded through the pooling process as follows:

Date	10 Year Pool			20 Year Pool			Total	
	Rate	Number	Amount	Rate	Number	Amount	Number	Amount
11/12/86	-	-	-	8.75	30	$ 7,087,000	30	$ 7,087,000
12/17/86	7.75	4	$ 753,000	8.45	63	14,717,000	67	15,470,000
1/07/87	7.75	10	2,315,000	8.45	34	6,041,000	44	8,356,000
2/11/87	-	-	-	8.40	54	10,784,000	54	10,784,000
Total		14	$3,068,000		181	$38,629,000	195	$41,697,000

There are 79 Certificates outstanding and most are being held by insurance companies or in name of nominees. The largest is $5,784,000 and the smallest is $100,000. There have only been four (4) secondary market transactions two (2) of which were at par and two (2) were at a premium of 1/2% of 1 percent.

SBIC Debentures

Two fundings of the SBIC Program have occurred under the authority of Public Law 99-272. The first sale of certificates closed on September 24, 1986, and funded debentures totalling $67,190,000 issued by 36 licensees. The debentures and certificates, which carry SBA's full faith and credit guarantee of timely payment of principal and interest, were for a term of ten years at a coupon interest rate of 8 3/4%. The second sale closed on February 4, 1987 and funded a $49,230,000 pool of 25 SBIC ten year debentures at a coupon interest rate of 7.95%. The poolers (underwriters) for both sales were Citicorp Investment Bank, The First Boston Corporation, and Goldman, Sachs & Co.

DEPARTMENT OF THE NAVY
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20350-1000

RECEIVED
APR 28 2 04 PM '86
OFFICE OF THE ADMINISTRATOR

APR 22 1986

Mr. Charles L. Heatherly
Acting Administrator
U.S. Small Business Administration
1441 L Street, N.W.
Washington, D.C. 20416

Dear Mr. Heatherly:

Enclosed is a copy of the fully executed Memorandum of Understanding between our respective agencies under which we will jointly implement an 8(a) Competition Test Program. The Department of the Navy will represent the Department of Defense in testing price and other competition utilizing 8(a) contracting procedures. We believe that the Test will provide an excellent opportunity to evaluate the enhancement of 8(a) business development and related Defense contracting procedures achievable through specialized competition.

We are fully committed to the accomplishment of the milestones identified in the Memorandum. We look forward to working with you and your staff during the course of our joint implementation of the Test Program.

Everett Pyatt
EVERETT PYATT
ASSISTANT SECRETARY OF THE NAVY
(SHIPBUILDING AND LOGISTICS)

MEMORANDUM OF UNDERSTANDING
BETWEEN
THE UNITED STATES SMALL BUSINESS ADMINISTRATION
AND
THE DEPARTMENT OF THE NAVY

THIS AGREEMENT, effective upon signature, between the United States Small Business Administration, (hereinafter referred to as SBA) and the United States Department of the Navy, (hereinafter referred to as Navy);

WHEREAS, SBA and Navy desire knowledge as to the benefits of competition in the 8(a) program; and

WHEREAS, SBA and Navy intend to enter into contracts under Section 8(a) of the Small Business Act to test the use of price and technical competition within the 8(a) Business Development Program; and

WHEREAS, SBA and Navy desire to develop procurement procedures applicable to this 8(a) Competition Test Program, consistent with 13 CFR 124, the Federal Acquisition Regulations, and the overall 8(a) program objectives:

NOW, THEREFORE, The parties agree as follows:

(1) Navy and SBA jointly will select, utilizing existing Section 8(a) offering procedures, potential acquisition requirements which appear to be within the capability range of two or more certified 8(a) concerns, considering the anticipated technical and/or price competition;

(2) The Navy will issue solicitations to those 8(a) firms formally identified by SBA as eligible to compete.

(3) Navy, to the extent generally provided by FAR and SBA regulations, will be responsible for all procurement actions up to the point of contract execution for such solicitations issued hereunder.

(4) Navy will prepare all necessary contract documents and coordinate contract execution with designated SBA contracting offices.

(5) SBA shall not provide Advance Payments or Business Development Expense funds under this program.

(6) Should termination procedures be necessary under contracts let under this program, Navy shall provide fifteen (15) working days advance notice to the SBA Contracting Officer.

(7) SBA and Navy shall each name a Program Manager to administer the overall 8(a) Competition Test Program on behalf of their respective agencies. Each agency shall designate its Program Manager within thirty (30) calendar days after execution of this agreement.

(8) SBA, in concert with the Navy, will develop criteria for selecting 8(a) firms, and Navy and SBA will jointly develop procedures for implementation of this 8(a) Competition Test Program within ninety (90) calendar days after execution of this agreement.

(9) A semi-annual evaluation of this program should be performed jointly with findings and recommendations submitted to appropriate agency officials.

(10) This agreement shall remain in effect until terminated by one of the parties, such termination shall be effective following a thirty (30) calendar day written notice of intent to terminate. In no event shall this agreement extend beyond two (2) years from date of execution.

Small Business Administration

4/16/86

(Date)

Everett Pyatt

Department of the Navy

APR 22 1986

(Date)

APPENDIX VI

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OF THE ADMINISTRATOR

SEP 29 1986

Honorable Lowell P. Weicker
Chairman
Senate Select Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

I am pleased to forward to you the Report on SBA User Fees as required by Section 18011 of Public Law 99-272 (The Reconciliation Bill).

The report was developed by an agency Task Force consisting of senior SBA staff officials and program managers. It represents the Agency's response to Section 18011 and our best judgments within the limitations of time available for the study. Section I of the report, the "Introduction," states several important caveats and limitations necessary to any interpretation of this data.

I am establishing a special Task Force of our National Advisory Council to assist the Agency in evaluating potential User Fee applications. It will hold its first meeting the week of October 27, 1986. It would be helpful if Mr. Robert Dotchin or someone from the Committee staff could address the group on the topic of the Committee's initial response to the Report and possible areas of mutual interest.

If we may be of any further assistance in this matter, please do not hesitate to call upon me.

Sincerely,

Charles L. Heatherly
Acting Administrator

Enclosures

Directorate of Cont, Cont Div, Bldg 241, Ft McClellan AL 36205-5000, Attn Patsye McLemore, Cont Specialist 205/238-5219, Harold Fredrickson Jr, Cont Officer, 205/238-4424

R -- PARA PROFESSIONAL SUPPORT SVCS for Education Transition [illegible] Program, Ft McClellan AL, for the period 1 Apr 87 thru 30 Sep 87 w/ 3 option yrs. Sol DABT02-87-R-0020 Issues approx 30 Jan 87 Opens approx 2 Mar 87 The govt contemplates award of a firm fixed price svcs cont resulting from this sol. All responsible sources may submit a proposal which shall be considered by the Agency. All reqs for sol must be submitted in writing. [illegible]

SBA, 1441 L St, NW, Rm 229, Washington, DC 20416

R -- FINANCIAL ADVICE REGARDING THE PACKAGING AND MARKETING OF DIRECT LOANS Sol RFP 87-14-CT BOD 02-20-87 SBA is seeking the services of an [illegible] financial advisor to assist the SBA in all aspects of developing and carrying [illegible] plan for the sale to investment markets of SBA direct business loans in the portfolios of the Business Loan & Investment Fund and in the Disaster Fund. The advisor will also assist in the development of a plan to offer the borrowers under disaster loans [illegible] the opportunity to prepay their loans at a discount. RFP will be released 1-20-87. Requests for copies of the RFP must be in writing to the Cont Officer. (005)

Space and Naval Warfare Systems Command, Washington, DC 20363-5100

R -- SUPPORT SERVICES FOR COMMAND AND CONTROL PROCESSOR PROGRAM (C2P) Navy JPO Office, Hanscom AF Base. Sol N00039-87-R-0198(S). POC V Doherty 202-692-6049. Qty 5 man-years. SPAWAR plans to award to sole source cont to PE Systems Inc, 5620 Cherokee Ave, Alexandria, VA 22312. When calling be prepared to state name, address and sol no. See Note 22. All responsible sources may submit an offer which will be considered. (005)

Space and Naval Warfare Systems Command, Washington, DC 20363-5100

R -- PROGRAM COST/ENGINEERING SUPPORT FOR SURTASS Sol N00039-87-R-0202(S), POC L Pena, 202-692-6049. Program cost engineering support for SURTASS, qty 1 lot. SPAWAR plans to award to sole source contract to [illegible] Engineering Research Inc, 2011 Crystal Drive, Suite 609, Arlington, VA 22202 closing date o/a 5 Feb 87. When calling be prepared to state name, address and sol no. See Note 22. All responsible sources may submit an offer which will be considered. (005)

Commandant, G-CAS-4, US Coast Guard Headquarters, Washington, DC 20593-0001, Attn: Mrs Karen Scott, 202/267-2561

R -- REGISTER AND COORDINATE US COAST GUARD RADIO FREQUENCY ASSIGNMENTS with International Telecommunications Union International Frequency Registration Board. PR DTCG23-87-Q-61314 should be received 15 days of this pub. Negotiations [illegible] only with Systematics General, 1606 Old Ox Rd, Sterling, VA 22170. See Note 22

J Maintenance and/or Repair of Equipment

Directorate of Contracting & Manufacturing, Oklahoma City, ALC, Tinker AFB, OK 73145

J -- OVERHAUL/REPAIR (REQUIREMENTS TYPE CONTRACT FOR PUMPS) Line Item 0001: NSN 4320-00-540-2027HS and or 4320-00-289-5337HS and or 4320-00-540-3540HS. Item dims: 4" dia x 10" long with 2 1/2" x 2 1/2" [illegible] on side and 3" x 3" mounting plate on bottom. Material content: Steel, aluminum, rubber, copper and brass. Description and function of item: Electric motor driven hydraulic pump with 800 psig, 1GPM with continuous cycles of five seconds "on" and ten seconds "off" followed by one hour "off". Pump dry weight 7.5 lbs with "in" port "out" port and a drain. Motor pump [illegible] on ground only to provide hydraulic pressure. Line Item 0002: NSN 4810-00-526-3865HS. Item dims: Weight: 2.35 lbs, width: 4", height 6.5", length 9.2". Material content: Alum alloy body, steel, nylon and plastic. Description and function of item: An electro magnetic valve, pilot operated hydraulic four way solenoid valve. Line item 0003: NSN 1660-00-139-8656. Item dims: 8.50" x 5.36" x 16.70". Material content: Alum alloy. Description and function of item: Provides oil storage. 0001 est max qty Basic: 12 ea, opt I 12 ea, opt II 12 ea; 0002 est max qty Basic 50 ea, opt I 25 ea, opt II 15 ea; 0003 est max qty Basic 15 ea, opt I 10 ea, opt II 10 ea. [illegible] Tinker AFB OK. Sol will be issued to Dowell Inc, 800 E 15th St, Wellington, KS 67152; U S Dynamics Corp, 425 Bayview Ave, Amityville, NY 11701 and Western Avionics Inc, 2428 N [illegible] Moore OK 73160-1285. All responsible sources may submit a bid, proposal or quotation which will be considered. This is 100% SBSA. Award may include options. Overhaul repair. There is a basic yr. Plus 2 option period plus a 90 day 25% option. Govt furnished material (G.F.M.) RFP 87-R-0309. To issue o/a 23 Jan 87. Closing date o/a 23 Feb 87. For sol info contact OC-ALC Richard Dawson/PMZAA, 405/739-4461. See Notes 27, 34, 44. (386)

D[illegible] of Contracting & Manufacturing, Ogden Air Logistics C[illegible] Hill AFB, UT 84056

J -- EQUIPMENT REPAIR Provide effort for fixed qty of item appl to the C-5A, C-141 as follows: (0001) PCB assy, NSN 6630-01-050-3166, P/N 170-301-0051, 1 ea; (0002) PCB assy, NSN 6630-01-080-3585, P/N 170-301-0250, 2 each; (0003) PCB assy, NSN 6630-01-051-0935, P/N 170-301-0340, 3 each; (0004) Dif Amp Assy, NSN 6630-01-073-5205, P/N 170-701-0051, 4 each; (0005) PCB Assy, NSN 6630-01-050-6627, P/N 170-701-0211, 5 each. Del to Hill AFB, UT o/a 60 days after receipt of contract and item. This notice is for Sol F42600-87-Q-20835 which will be issued approx 87 Jan 26. To: IMO Corp, Los Gatos CA 95030 with an approx closing date of 87 Feb 26. For copy of sol contact: Norma Jensen, PMXOD 801-777-5095. For additional info contact: Paul N Reed, PMZET 801-777-8416. Authority: 10 U.S.C. 2304(C)(1). Justification: supplies (or services) required are available from only one responsible source and no other type of supplies or services will satisfy agency requirements. No tel requests. Only written requests received directly from the requestor are acceptable. Notes 22, 27, 33, 40, 73.

J -- ESSENTIAL REPAIR of a fixed qty of items appl to the F-111 simulator as follows: (0001) video amp, NSN 6930-01-071-8316, P/N 170-705-0090, 6 ea. Del to Hill AFB, UT o/a 60 days after receipt of contract and item. This notice is for Sol F42600-87-Q-20840 which will be issued approx 87 Jan 26. To: IMO Corp, Los Gatos CA 95030. To: The Singer Co, Binghamton NY 13902-1237 with an approx closing date of 87 Feb 26. For copy of sol contact: Norma Jensen, PMXOD 801-777-5095. For additional info contact: Paul N Reed, PMZET 801/777-8416. All responsible sources may submit a bid, proposal or quotation which shall be considered. No tel requests. Only written requests received directly from the requestor are acceptable. Notes 27, 33, 73. (006)

[illegible]eet Cont Ctr, NSC JAX Bldg 191C, Mayport FL 32228-0068

J -- REPAIR OF MAIN FEED PUMP N68836-87-R-0823. Closes 02/4/87. Contact John [illegible] code 202.102, 904-241-6488; cont officer Sharon Scher code 202.1. [illegible] class "B" repair to 1 ea main feed pump turbine, mfd by Worthington Corp. [illegible] is to a turbine [illegible], type [illegible], single stage, operating steam 1100 psig, [illegible] deg temp, dwg L/64010, APL 06730060. The dwg and the APL will be provided with the sol. Repairs shall be IAW tech repair std 2562-086-630 for FF 1052 class, which shall be provided w/the sol. To be eligible for an award, offerors must be considered qualified by NAVSEA. To obtain info for inclusion on the NAVSEA Qualified Svcs List (QSL) [illegible], contact Don Taylor 202/692-0450. Dept of the Navy, Naval Sea Systems Command, Code SEA 5672, Washington DC 20362. The following NAVSEA instructions are also appl. For availability contact Don Taylor: NAVSEA 0919-000-9010 "Procedure for Electro-Deposition of Chromium on Steel Shafting"; NAVSEA 250-637-4 "Instructions for Straightening Shafts or Similar Objects"; NAVSEA 0947-LP-107-8010; NAVSEA instruction 4710.11 "Overhaul of Designated Mission Critical Eqpts (Hull, Mechanical and Electrical)". The following mil stds and specs are also appl. They are avail from US Naval Pubs and Forms Ctr (see Note 9): MIL-STD-167 "Mechanical Vibration of Shipboard Eqpt"; MIL-STD-271 "Non-Destructive Testing Rqmts for Metals"; MIL-STD-278 "Fabrication Welding and Inspection of Machinery, Piping and Pressure Vessels of Ships of the US Navy"; MIL-S-22473 "Sealing, Locking and Retaining Compounds, Single Component"; Handbook H-28 "Screw Thread Stds for Fed Svc". FOB dest Mayport FL, svcs are desired to be completed 60 days after date of cont. All responsible sources may submit a proposal which shall be considered by the Agency. (However, see qualification rqmts specified above.) See Note 9. (006)

Directorate of Contracting & Manufacturing, Oklahoma City, ALC, Tinker AFB, OK 73145

J -- REPAIR LTN 51 AND LTN 104 NAVIGATION SYSTEMS Sol is being issued to Litton Aero Products Div, Moorpark, CA for a one yr cont for the repair of the LTN 51 and LTN 104 Inertial Navigation Systems. The requirement is for an estd 30 systems that consists of the following: (1) INU: NSN 6605-01-006-6692, 6605-00-166-5885, P/N's 663450-14, 663450-08-22. The INU consists of various metallic alloys and electronic components and measures 10" x 8.5" x 19.6". It provides navigation and targeting info to be displayed on CDU and other acft indicators. (2) CDU NSN's 6605-01-009-9083, 6605-00-165-5886, P/N's 662560-04-201, 662660-04-201 and 662660-04-200. The CDU consists of various metallic alloys and electronic components and measures 5.75" x 4.5" x 6.75". The CDU provides interface between acft flight crew and the INU. (3) MSU NSN 6605-00-166-5888, P/N 663570-03. The MSU consists of various metallic alloys and electronic components and measures 5.75" x 1.5" x 2". The MSU provides acft flight crew control energizing and aligning ins prior to flight and for selecting the navigation mode. Del to Tinker AFB OK. Sol will be issued to Litton Systems Inc, Aero Prod Div, 6101 Condor Dr, Moorpark, CA 93021-2699. "All responsible sources may submit a bid, proposal or quotation which will be considered". Exception to F & OC "FAR 6.302 (1)(A)". Sol RFP 87-R-0313. To issue o/a 28 Jan 87. Closing date o/a 27 Feb 87. For sol/info contact OC-ALC Dorothy Fox, PMZIA, 405-739-4408, Tinker AFB OK 73145-5320. See Notes 27, 22, 33, 40, 26 and 73. Ref Note 33 for qualification procedures, contact OCALC/OPS, Tinker AFB OK 73145-5990. (006)

Naval Regional Cont Ctr, US Naval Base, Bldg 600, Phila PA 19112

J -- MAINTENANCE OF SCATS AT SUB-CONTRACTOR FACILITY NRCC Philadelphia intends to acquire on a sole source basis from Harris Corp, Govt Support Systems Div (GSSD), repair svcs for 8 simulator controlled automatic test sets (SCATS) being utilized at Harris GSSD subcontractors during the performance of N00140-84-C-4843 covering avionics test set AN/USM-470(V)-2. Six SCATS units are located Boeing Corp, Huntsville AL and 2 at Sparr Aerospace, Kanata, Ontario CN. Period of performance shall be 1 Jan 87 to 31 Dec 8[illegible]. This cont action is for supplies or svcs for which the govt intends to solicit and negotiate w Harris Corp Govt Support Systems Div (GSSD) under the authority of FAR 6.302-1. This firm is considered the only supplier of these supplies or svcs because Harris GSSD is the designer, developer and sole mfr of the abovementioned eqpt. The govt will not pay for info received. All responses should be directed to the tech POC D McClure, PMAL at 215/897-5638. The cont officer is B J McDevitt PSA at 215/897-5421. (006)

Space and Naval Warfare Systems Command, Washington DC 20363-5100

J -- REFURBISHMENT AND DESIGN UPDATE OF AN/TPS-63 Sol N00039-87-R-0200(S). POC D Lawrence 202-692-4815. Refurbish and design updating of the TWT stage of the Marine Corps AN/TPS-63 radar preproduction model, serial A-2, which was originally deferred in the basic cont statement of work. Under the basic cont N00039-85-C-0680 Westinghouse is currently refurbishing and design updating two preproduction AN/TPS-63 radars, except that on serial A-2, the work on the TWT driver stage hardware has been deferred. The subject effort will be a one time add-on to N00039-85-C-0680. Qty 1 lot. Spawar plans to award to sole source cont to Westinghouse Electric Corp, Defense & Electronics Center, Command and Control Div, Mail Stop 984, Baltimore MD 21203. Closing date o/a 2 Feb 87. When calling be prepared to state name, address and sol no. See Note 22. All responsible sources may submit an offer which will be considered. (006)

OIC, Facility Support Contracts, Bldg M-32, Norfolk Naval Shipyard, Portsmouth, VA 23709-5000, 804/396-5121

● J -- CORRECTION: REPAIRS, ALTERATIONS, OVERHAUL, AND MAINTENANCE OF GOVERNMENT-OWNED TRUCKS, TRACTORS, AND BUSES Norfolk Naval Shipyard, Portsmouth, VA. This is a time material qty contract. The contractor shall furnish all shop facilities, labor, transportation, tools, equipment and [illegible] necessary to transport vehicles to be repaired to and from his facilities and to perform repairs, alterations, overhaul and maintenance of but not limited to: disassembly, reassembly, inspection, cleaning, adjustments, replacement of parts, test as applicable to correct defective item(s), electrical systems, engine body, chassis and drive systems of Govt owned trucks, tractors & buses. IFB N62470-86-B-5873 [illegible] 05-06-5873 advertising date 9 Jan 87. BOD 11 Feb 87. Est cont range is between $100,000 and $250,000. (005)

ROICC, Bldg 513, Rm 202, Mare Island Naval Shipyard, Vallejo CA 94592-5100

● J -- BICYCLE MAINT at the Mare Island Naval Complex, Vallejo CA. N62474-86-B-9626. BOD 040187. Contact [illegible], 707/567-2107; cont officer CDR J J Wong Jr. Perform repairs on govt-owned bicycles. The proposed cont will be a Rqmts cont by which the govt will not guarantee that it will order a specified amt during the term of the cont, but does agree that all supplies or svcs required by the govt covered by the cont will be ordered from the contractor. The term of the cont will be for a period of 1 yr w/ a govt option to extend the cont for periods NTE 60 mos. The estd start is between 16 Apr and 1 May 87. A copy of the sol will be avail approx 2 Feb 87. The proposed cont is 100% SBSA and under SIC Code 7699. All responsible sources may submit a bid, which will be considered by the cont officer. See Notes 13, 89. (005)

NASA, George C Marshall Space Flight Center, Procurement Office, Attn: Marshall Space Flight Center, AL 35812

J -- MAINTENANCE AND REPAIR of Govt-Owned Perkin Elmer Equipment. RFP No. 8-1-7-CK-00610. BOD o/a 1/20/86. Contact Check Comer, AP28, 205-544-0303. Laura S Reed, cont officer. Period of performance to be for one year for on-call preventive and remedial maintenance of all Govt Owned Perkin Elmer equipment located at NASA MSFC. Closing date shall be announced in the sol. Negotiations shall be conducted with Perkin Elmer Corp, 510 Guthridge Court, Norcross, GA 30092. Perkin Elmer is the equipment mfr and only known source with the factory trained service engineers, electronic data, specialized test equipment and a complete inventory of parts capable of performing this work in a satisfactory manner. All responsible sources may submit a proposal which shall be considered. See Note 22. (005)

Naval Sea Systems Command, Code 0243, Washington DC 20362-5101

J -- ENGINEERING FIELD SERVICES, CONTINUOUS DUTY, DOMESTIC/FOREIGN, MOTU-1, PEARL HARBOR, AND MOTU-5, SAN DIEGO, for min of 242 M/D's and max of 252 M/D's including support and data to assist in the maintenance and repair of Type 2/8, 15/18 Submarine Periscopes during FY 87. One-year options are available for min of 484 M/D's and max of 504 M/D's including data and support during FY's 88 and 89. RFP N00024-87-R-4223 will be issued to Electro-Optical Div of Kollmorgen Corp, 347 King St, Northampton MA 01060 and Sperry Corp, Rt 29 N, Charlottesville VA 22901 because they are the only firms that possess the necessary data, expertise, and special tooling since they are the only manufacturers of the Type 2/8, 15/18 Submarine Periscopes. See Notes 40 and 48. (006)

Naval Sea Systems Command, Code 0295, Washington DC 20362-5101

J -- REGULAR OVERHAUL OF USS ELLIOT (DD-967). The sol will be issued to offerors on the West Coast; however, a decision has not yet been made as to whether this procurement will be restricted to participation by small businesses. Firms interested in subcontracting opportunities, please refer to Note 27. RFP N00024-87-R-8[illegible] will be issued to the following firms, among others: Lockheed Shipbuilding and Construction Co, 2929 16th Ave SW, Seattle WA 98134; Northwest Marine Iron Works, 2516 NW 29th St, Portland OR 97208; National Steel and Shipbuilding Co, Harbor Drive at 28th St, San Diego CA 92138; Southwest Marine Inc, Foot of Sampson St, San Diego CA 92113 and Todd Pacific Shipyards Corp, Los Angeles Div, 710 Front St, San Pedro CA 90733. (006)

Smithsonian Institution, Office of Proc & Property Mgmt, 955 L'Enfant Plaza, SW, Suite 3120, Washington DC 20024, attn Code 19

J -- NECESSARY REPAIR RENEWAL PARTS AND CALL BACK SERVICING of all heating, ventilation and air conditioning system located at the Natl Zoological Park, Washington DC, and Front Royal VA, as specified in the RFP. RFP Fh 7021-86

J -- REPLACEMENT OF TRANSFORMERS at the Natl Zoological Park, Washington DC, as set forth in the specs and dwgs and as specified in the RFP. RFP Fh 7025L (005)

Naval Sea Systems Command, Code 02614, Washington DC 20362-5101

J -- REPAIR/MATERIALS FOR AN/SQS-56 SONAR AND AN/SQQ-23 SONAR RECORDERS NAVSEA plans to issue BOA N00024-87-G-[illegible] to Raytheon Co, Submarine Signal Div, Portsmouth RI for repair, refurbishment, overhaul and installation of AN/SQS-56 Sonar and AN/SQQ-23 Sonar Recorders under the authority of 10 USC Section 2304(C)(1) since this company is the current manufacturer and has the necessary background knowledge and resources to perform the required efforts. See Note 22. Address any inquiries to Attn Code 02614, M Johnson 202-692-0951. (006)

Contr Div, HSHL-LP SVC, Bldg T-20, First Floor, Walter Reed Army Medical Center, Washington, DC 20307-5000

J -- PREVENTIVE MAINTENANCE AND EMERGENCY SERVICE of Government owned Nicolet Fourier Transform Infra Red Spectrometer System for a period of one year

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

JAN 29 1987

Dear

This letter is in response to your December 29, 1986, unsolicited proposal to purchase the direct business loan portfolio from the Small Business Administration. Your interest in our programs is greatly appreciated, but we have decided that your offer cannot be considered at this time.

We have issued a Request for Proposals (RFP) to hire a financial advisor. The job of the financial advisor would be to counsel SBA on the best ways to package and market its direct loan portfolio. Development of the RFP began late last fall and was in process when your proposal was received.

Your firm may be interested in bidding for the financial advisor contract, or, if SBA decides to offer the direct loans for sale, bidding to purchase them at that time.

A copy of the RFP is currently available from the Office of Procurement. If you are interested in receiving a copy, you may request it in writing from Ms. Catherine Thomas, Contract Officer, Room 219, Small Business Administration, 1441 L St. NW, Washington D.C., 20416.

Thank you for your proposal to purchase SBA's direct business loans. Again, the interest of a major investment firm such as in SBA programs is greatly appreciated.

Sincerely,

Edwin T Holloway

Edwin T. Holloway
Associate Administrator for
Finance and Investment

SMALL BUSINESS ADMINISTRATION
FY 1988 CONGRESSIONAL SUBMISSION
ANALYSIS OF ADDITIONAL REVENUE ESTIMATES BY ACTIVITY
($ IN THOUSANDS)

05-Jan-87

PROGRAM/PROJECT	Requested Amount	Estimated Receipts	Explanation of Revenues
PASS	$1,700	$1,700	Annual listing fee of $10 and hourly usage fee of $30
Certificates of Competency	2,130	400	Application fee of $200
Small Business Institutes	2,071	1,435	Fee for counseling at $ 200 per case
SCORE	2,120	1,800	Fee for training @ $25.00 per attendee
Business Development Publications	400	257	Current charges for publications
Women's, Vet's, & IT Conf. & Publ.	1,945	1,095	Fee for publications and fee for conference attendees
State of Small Business	50	50	Fee for publication
Small Business Innovation Research	1,214	75	Annual subscription fees @ $5 each
Advocacy Database	1,908	225	Sale of Customized and Standardized Data Base Outputs
Hearings and Appeals	1,073	45	Size and SIC Appeals at $200 per appeal or protest
Other Salaries and Expenses	292,767	250	Fee for 8(a) program applicants
Subtotal	300,250	7,332	
Business Loan & Investment Fund	100,750		
		45,000	Additional 2% Guaranty Fee on General Business Guaranty Approvals
		350	Additional 1% Guaranty Fee on 502 DCL Guaranty Approvals
		5,070	Additional 1.5% Guaranty Fee on 503/504 DCL Guaranty Approvals
		2,330	Additional 1% Guaranty Fee on SBIC Guaranty Approvals
		15,000	20% of premium earned on Secondary Market transactions
Subtotal		67,750	
Disaster Loan Fund	0	5,000	Increase int. rates comparable with bus. loans & keep the 1% add-on
Surety Bond Fund	15,000		
		2,630	Increase in surety fee to 25% of $10 fee
		5,200	Increase in contractor's fees to $8/1000
Subtotal		7,830	

FY 1988 Congressional Budget Proposals	Legislation Required
1. Consolidate all guaranteed credit programs into three major programs: General Business Assistance, Economic Development Assistance, Investment Assistance.	yes
2. Provide generally the same level of funding for guaranteed programs as appropriated in FY 1987.	No, but Appropriations required.
3. Increase General Business Loan guaranty fee from 2 to 3 percent to the borrower plus a 1 percent fee to be paid by the bank.	yes
4. Phase down the 90 percent guarantee of General Business lending to 75 percent by FY 1992.	yes
5. Reduce direct Minority Enterprise Small Business Investment Company (MESBIC) lending to $20 million from FY 1987 appropriated level of $39 million, while providing $14 million for a new MESBIC guarantee program.	no
6. Decrease 100 percent guarantee of Small Business Investment Companies (SBIC) to a 90 percent guarantee.	yes
7. Increase the funding level for the Surety Bond Program from $1,096 million in FY 1987 to $1,250 million in FY 1988.	no, but Appropriations required.
8. Provide Disaster Assistance in FY 1988 under current policy. However, in FY 1989 limit eligibility to those disaster victims who cannot obtain credit elsewhere.	yes

FY 1988 Congressional Budget Proposals	Legislation required
9. Eliminate all other direct business lending.	yes
10. Eliminate the Pollution Control Financing Program.	yes
11. Sell approximately $1.5 billion of General Business and Development Company loans in FY 1988.	no, but would facilitate implementation of proposal.
12. Sell approximately $800 million of Disaster loans in FY 1987 and FY 1988.	no, but would facilitate implementation of proposal.
13. Minority Business Development Agency (MBDA) will be transferred to SBA and consolidated into MSB/COD. This will include 140 full-time equivalent (FTE) positions and $36 million, including $24 million MBDA grant funds.	yes, or by Executive Order.
14. Section 7(j) assistance will be made available to trade groups only. Sec.7(j) funding level will be reduced from $9.6 million to $4.8 million and merged with the $24 million MBDA grant funds.	yes or by Executive Order.
15. Business Development Expense (BDE) will be eliminated.	no
16. Reduce statutory cap on Small Business Development Center (SBDC) program from $65 million to $45 million.	yes
17. Phase out federal funding of SBDCs over the next 5 years.	yes
18. Postpone funding of new SBDCs until FY 1988.	no

	FY 1988 Congressional Budget Proposals	Legislation required.
19.	Reduce FY 1987 funding level by $4.1 million and transfer availability to FY 1988 for actual program level of $31 million.	no
20.	Maintain in FY 1988 the level of employment as was available in FY 1987.	no
21.	Integrate Private Sector Initiative program with the Office of Business Development.	no
22.	Based upon the results of the needs and requirement study already underway, additional funding would be requested for FY 1988, if necessary.	no
23.	SBA is to increase its A-76 (contracting out) efforts in Portfolio Management and Administrative functions in order to identify savings in FY 1989 and beyond.	no

24. The following user fees could be imposed administratively:

*PASS: Annual listing fee of $10 and hourly usage fee of $30
*Certificates of Competency : Application fee of $200.
*Small Business Institutes: Fee for counseling/$200 per case
*SCORE: Fee for training/ $25 per attendee
*Business Development Publications: Current charges for publications
*Women's, Vets & International Trade Conferences and Publications: Fee for publications and for conference attendees
*State of Small Business: Fee for publication
*Small Business Innovation Research: Annual subscription fee of $5
*Advocacy Database: Sale of Customized and Standardized Data Base Outputs
*Hearings and Appeals: Size and SIC Appeals at $200 per appeal or protest
*Other Salaries and Expenses: Fee for section 8(a) program applicants

- *SBICs: Additonal 1 percent guaranty fee on guaranty approvals
- *Surety Bond Fund: Increase in surety fee by 25 percent of $18 fee
- *Surety Bond Fund: Increase in contractor's fees to $8/1000

25. The following user fees would require legislative action:

- *502 Development Company Loans: Increasing by 1 percent the guaranty fee on 502 Development Company Loan guaranty approvals
- *503/504 Development Company Loans: Increasing by 1.5 percent the guaranty fee on 503/504 Development Company Loan guaranty approvals
- *Disaster Loans: Increase interest rates comparable with business loans and retain the 1 percent administrative fee.
- *Charging a fee of 20 percent of the premium earned (or a minimum or $100) on Secondary Market transactions.

Acting Chairman SKELTON. Mr. Ireland.

Mr. IRELAND. Thank you, Mr. Skelton.

I appreciate the thrust of those remarks, Mr. Heatherly. It sounds as though we are all going to get off to a collegial start here today, and I tip my hat to you and the others in the agency and in the administration for taking that viewpoint.

Could you elaborate, if you would, on how the sale of assets which you contemplate, how it will take place, and give the members an idea of how it will operate and why you think that it would be successful to the degree that you have indicated in the budget?

Mr. HEATHERLY. We are proceeding on two tracks on the loan asset sales. We have committed and do plan to proceed with the sale of our disaster home loan portfolio of approximately $800 million this fiscal year if the calendar permits.

We have proposals that have been worked up inside the agency. We have authority to do those sales under current law. And our present thinking is, and we believe we have agreement with OMB to proceed in this direction, is to offer those disaster home loans first to the borrower at a discount, in other words a buy-back of the loans.

We do not see many downsides to this. It is an optional, voluntary thing. If someone prefers not to, then they certainly are not required to.

The discount for that, we have not determined yet. We have a formula that we are looking at to try to set that. But we are looking at it in a broad neighborhood of about 50 cents, 50 cents on the dollar.

Bear in mind that those are very low interest loans, 2 and 3 percent, many of them. And to induce someone to buy those back on those favorable terms that they have already, it is not taken as a foregone conclusion that every one will be inclined to do that. The rest of our portfolio——

Mr. **Ireland.** How much of the portfolio is in that category?

Mr. **Heatherly.** A little over $800 million I believe. Is that correct?

[Pause.]

Mr. **Heatherly.** The home loan portfolio is a little short of $1 billion. But the home loan portion that we are proposing to sell this year would be in the neighborhood of $800 million.

Mr. **Ireland.** OK.

Mr. **Heatherly.** And if we did get 50 cents on the dollar, we are talking about a $400 million return over whatever period of time that it takes to complete the sale.

The remainder of our direct loan portfolio, we are looking at a RFP process that we have put out on the street, and I believe that it closed this week, the request for proposals for a financial advisor, a professional independent advisor to come on board and take a very in depth look at our portfolio, give us advice on what they think is the best road to go in terms of the discounting, the marketing, and the details of the sale.

The RFP we put out is very detailed in terms of what we are looking for. We will be evaluating the proposals that come in, and then bringing someone on board to do that analysis for us.

We are taking this route because recognizing that when we are doing something for the first time that we really do not have a track record, and the Government really does not have a good handle on the value of this portfolio or the discount required, and some of the mechanics of the sale process.

We do not want to do it in a reckless or imprudent manner. We want to take all necessary steps to try to get full value for that portfolio. So we are going the route of bringing on board an independent financial advisor from the private sector.

Mr. **Ireland.** What has been the response, you say that the RFP's ought to end today or tomorrow, has there been a good response, or not?

Mr. **Heatherly.** I believe that we have had a good response, and I will ask Ed Holloway to respond to that.

Mr. **Holloway.** Congressman, the RFP actually closes this coming Monday, March 2 at 2 p.m. We had requests for around 110 copies of the RFP, and we will not really know until Monday how many responses we are going to get.

However, we have a very positive indication from a number of the people who participated with us in our prebid conferences with respect to the sale of assets, and we expect a healthy number of proposals.

Mr. **Ireland.** Thank you.

Mr. **Heatherly.** I think that it will take 3 to 4 months for that advisor to complete the analysis of the portfolio and make recommendations to the agency. We will then share those recommendations and analysis not only with the administration but with the committee. And before final decisions are made, we will engage in full consultation with the committees of both Houses and keep everyone advised of how we are planning to proceed and the reasons therefor.

I do not think it likely that given the calendar and the administrative and mechanical steps that we have to go through, that it is probably unlikely that we would be initiating sales this fiscal year. We are looking at the first quarter of next year or afterward probably on the remainder of that portfolio.

It obviously depends upon the recommendations that the financial advisor comes up with in terms of the discount and the pros and cons of proceeding, based on the discounts recommended.

Mr. **Ireland**. Thank you.

Acting Chairman **Skelton**. Thank you, Mr. Ireland. Mr. Torres.

Mr. **Torres**. Thank you, Mr. Chairman.

Mr. Heatherly and your colleagues, welcome to the committee this morning. There are a number of areas that many of us have followed with great concern. I think, that as you previously stated, the SBA issue is now behind us, and that the agency is functioning at full force. I hope that all of the rumors that the agency was in its demise have been laid to rest.

I am a little concerned about the President's budget for SBA for fiscal year 1988. Basically it contains the same program levels appropriated for 1987, except that the President would eliminate—eliminate I repeat—the direct loans to the handicapped, to Vietnam veterans, and to minorities.

Could you give me the rationale for what I believe, and many of my colleagues join with me, is a deplorable move to eliminate these very important programs?

Mr. **Heatherly**. Yes, sir; the proposals to eliminate the direct loans are consistent with the previous administration's initiatives regarding direct loans in both this agency and other agencies. We do not believe philosophically and as a matter of policy that the Government should be in the direct loan business.

In a practical sense, the amount of money that is going to the public in the Direct Loan Program has been diminishing for several years under budget conditions. It is now quite small. And for 1986, of the loans being made to the minority community, for example, the figures, I believe, are that if you take into account the guaranteed loans that are going to minority owned firms that we are in fact having a much, much, greater and far greater impact on minority business through the Guarantee Loan Program than we are in the Direct Loan Program.

And that is even more true in the case of the veterans and handicapped; 96 percent of the volume of the loans that are going to veteran owned businesses are coming through the Guarantee Loan Program, not through the Direct Loan Program. And there are similar statistics for handicapped-assisted businesses.

Now you can say and we grant that for an individual firm that did receive a direct loan and may not have qualified for a guaranteed loan that it is certainly a loss to that firm. But we are saying that in terms of the broad picture and the macro picture and the total volume of loans that we are offering to the small business community that the Direct Loan Program is a very, very small part of that.

And we believe that the guarantee portfolio can and should absorb that, and we are already doing more for the minority community, for the veterans community and the handicapped owners through the Guarantee Loan Program.

Mr. TORRES. One of the mainstays of your activity in the field has been the small business development centers. These centers provide small businesses with the expertise to launch their individual businesses.

Does your program contemplate the elimination of the SBDC's?

Mr. HEATHERLY. Well, it may be a matter of semantics, Congressman, but I believe that it is important to make the distinction between the elimination of an institution and the phaseout of Federal funding for that institution.

Those SBDC's already receive a majority of their funding, the operating funding, from non-Federal sources. The matching fund provision has been very successful. And our Federal funds are already matched in greater part from State and private sources.

Our proposal is that the Federal funding and the Federal support for the SBDC's be phased out over a 5-year period. This is, I think, a significant change from last year's proposal which was for zero funding in fiscal year 1987.

We recognize that we cannot, overnight, defund a program of that magnitude and expect it to survive. But we do believe that a 5-year phaseout formula with the fully mature SBDC's that have been in the program for several years and are already at the cap being phased out over 3 years, and the newer ones being phased out over 5 years will give the States an opportunity to pick up the funding, and that most will do so over that period of time.

Mr. TORRES. I have about 30 seconds remaining, and I would like to get an answer to this question very succinctly. In your testimony at Appendix 9, it states that the proposed MBDA transfer could be done by legislation or by executive order.

If there is no legislation enacted by us in Congress, will you proceed by executive order?

Mr. HEATHERLY. We have not made that decision yet, Congressman, to be honest. We are looking at the executive order alternative. MBDA was created by executive order and exists by executive order, and it could be transferred by executive order. But we have not decided, neither the agency nor the White House, which will have the final decision, has not decided.

But I think that before we would do that, even if that were desirable from our standpoint in order to complete a transfer, we would expect to have some oversight hearings and to share with both committees the full details of what it is that is being proposed, what it would look like, the staffing, the operations, any new regulations that were required in terms of how that program meshes with our current 7(j) program, so that people will be very comfortable with that new configuration that we arrived at.

Mr. TORRES. Thank you very much. Thank you, Mr. Chairman.

Acting Chairman SKELTON. Thank you. The gentleman from North Carolina, Mr. McMillan.

Mr. MCMILLAN. Following on that particular point, am I correct to assume that there are no budgetary consequences in the proposed budget with respect to the transfer of MBDA?

Mr. HEATHERLY. Well, there are budget proposals in the Commerce budget as well as our own as to how this transfer will be accomplished. There are reductions in the appropriations levels recommended for the MBDA Program for the transfer. These are reductions in overhead functions, and overhead staff and overhead functions primarily.

There is some reduction in the grant funds in the MBDA Program. But all of the support level for the minority business development centers, the 100 centers that exist around the country, would be maintained. And we see that as the heart of the program, the enterprise development program, as being complementary to and very much a partner with our current 7(j) program, and the two would fit together very well and complement each other very well.

So there are some budget reductions. We believe that they are modest. They are in overhead functions, and not in essential services.

Mr. McMillan. So that would fall within the general objective of more cost effective delivery of equivalent programs?

Mr. Heatherly. That is correct, Congressman. We believe that we can deliver those services more efficiently and more effectively through a unified streamlined organization.

Mr. McMillan. Would you also direct similar comments to the SBDC centers. I think that there is some assumption of a reduction in funding for that as well.

Mr. Heatherly. Well, the SBDC's, the university based and college based assistance centers, we are proposing for a 5-year phaseout system. At the end of that 5 years, at the end of 1992, there would be no remaining Federal funding. They would be entirely a State responsibility. And there is a formula or an alternative formula about how to accomplish that for each individual State. We have not arrived at conclusions yet on what that should be.

We do have a proposal that $4.1 million of our 1987 existing appropriation be deferred and spent in 1988 instead. And the reason for that is that we do not believe that we should be funding or bringing new SBDC's. The eight remaining States that do not have SBDC systems, we do not believe that we should be bringing those into the program this year while we are debating and possibly adopting a phaseout of the program.

Mr. McMillan. What is the total amount of that funding this year?

Mr. Heatherly. The total appropriated amount is $35 million. We are proposing to spend only $31 million or $30.8 million of that, and to defer the rest until next year to be part of next year's appropriation. That is a very significant part of our S&E budget, and dwarfs much of what else we do in the management assistance area.

It may not sound like a lot of money in terms of a trillion dollar budget, but $35 million is a very large part of our operating budget for management assistance.

Mr. McMillan. Since we are talking in terms of transference of this to other entity States, do you have an estimate of how much States are spending on the same programs at the present time?

Mr. Heatherly. I would like to defer to Mr. Cox on that. I believe that we have some statistics that are in the neighborhood of about $1.4 for each Federal dollar that is being spent in the States that have SBDC's. Now many States like California that do not have a SBDC system nonetheless have small business assistance programs operating in the State that are just not part of our Federal system. But John, do you want to add to that.

Mr. Cox. Yes, Congressman; the ratio of match is $1.43 to $1. So it would be $50 million to the $35 million roughly.

Mr. McMillan. So basically then, the program would be based upon the assumption that the States are going to, more or less, over 5 years if they want to continue the program as is, have to almost double their commitment to it?

Mr. Heatherly. Plus there are additional options. We are trying to encourage the SBDC's to become a little more self-sufficient through user fees, fees charged for their training programs for example, and their long-term consulting services.

So that we believe that there is potential private sector support from the clients of that program that can help supplement the State funds if they will pursue that more systematically than has been done in the past.

There are existing user fees being employed, but it is not systematic. And we believe that by a more systematic approach that the program can become more self-sufficient in terms of the supplement to the State funding.

Mr. McMillan. One further question on asset sales. I have not had a chance to totally review your proposed budget.

But in the aggregate, what is the aggregate amount of asset sales that are included in your proposal?

Mr. Heatherly. $2.2 billion for 1988, and $800 million in 1987. That is the disaster home loan portfolio in 1987. And the remaining approximately $3 billion in the portfolio would be in future years. If we decide to continue the sale, it would be in the out years.

Mr. McMillan. That would then be viewed as a permanent reduction. In other words, it does not really impact your budget, but it is a net in-flow of cash that would then not be redeployed for any other purpose within the SBA budget, it would go back to the Treasury?

Mr. Heatherly. That is correct. It is an offset; it is a revenue offset that affects the net outlay figures, but it does not affect the budget authority figures per se, except in the case where we have revolving funds where there is a one-to-one offset within that account, as we have already existing within the disaster program.

But obviously, the assets sales are revenue producing vehicles. It does not necessarily affect the appropriation levels or the program levels for the future years. You can continue to increase or decrease regardless of what you are doing in terms of asset sales of the existing portfolio.

Mr. McMillan. I think that concludes my time. Thank you very much.

Acting Chairman Skelton. Mr. Campbell.

Mr. Campbell. Nothing at this time.

Acting Chairman Skelton. Thank you, sir. Mr. Gallo just left. Mr. Olin.

Mr. Olin. Thank you very much, Mr. Chairman.

Mr. Heatherly, I did not arrive here in time to hear your whole testimony, but I see that you have left us quite a packet of material which I think that we will read with interest. I would like to congratulate you on surviving the demise of the SBA, and, in fact, coming out on top. I think that all of us are very pleased with that occurrence.

Now I just want to ask you a little bit about the disaster loan area. Your largest portfolio is disaster loans, about $4 billion I believe. I have not studied this enough to have a very good feel for what the financial impact of it is likely to be one way or the other, selling the portfolio versus not selling it.

The delinquency rate is not unusually high considering the nature of those loans. It is somewhere around, I think, 8 percent for ordinary loans and maybe 14 percent on farms being a little worse. The interest rates vary quite a bit. In recent times they are either 4 or 8 percent, which, at least the 8 percent ones are favorable rates.

Do you have a feeling as to the effect selling the portfolio may have on the Government?

Mr. HEATHERLY. In terms of the discount that we are going to have to——

Mr. OLIN. Well, yes; whether you are going to have to discount them too much. The estimates so far are that you will discount to maybe 34 cents on the dollar or something like that.

Is that a bad deal for the Government or a good deal?

Mr. HEATHERLY. Well, I suppose that depends on your perspective and what you are trying to accomplish with the asset sales. I think that the estimates on the return or the value are just that, big ball park estimates, and that is why we had decided to bring on a professional independent advisor to help us get a handle on it before we proceed.

Assuming for the moment that the discount would be in that neighborhood of 35 to 40 cents on the dollar return, we feel that there are imperatives on the present budget situation which I think that the Congress shares because the Budget Committees of both Houses debated and gave a lot of interest in the assets last year as an alternative to an appropriations reduction.

Mr. OLIN. That was not an answer to my question.

My question is was it a good deal for the Government or not, not whether it is popular or not?

Mr. HEATHERLY. Well, when you ask whether it is a good deal for the Government, you have to take the Government's total interest into account, and balancing the budget is one of the interests and the bipartisan interest of this Government. And I think that asset sales are one acceptable vehicle in terms of a short-term solution to get over the tremendous problem that we are encountering in the near term on these deficits.

Mr. OLIN. I understand that, Mr. Heatherly. But could I just make the request that as you are looking into this that you try to gather for the committee some actuarial or accounting analysis of just what this means to the financial picture of the Government without regard to the question of balancing the budget. I understand that, of course, as well.

Mr. HEATHERLY. If your question is, Congressman, the return to the Government if we held them to maturity and to term under our present system versus what we achieve on the sale.

Mr. OLIN. Right.

Mr. **Heatherly**. There is some expected loss or differential in that income. But you also have the opportunity costs or the costs of that money over that period of time.

Mr. **Olin**. Could I interrupt you? I want to ask one other question. Excuse me for interrupting, but my time is about up. I introduced a bill last year and have reintroduced it this year, as you are probably aware, to change the handling of the disaster loans from direct loans to guaranteed loans through commercial banks.

I did that for two reasons. One is the great difficulty I had getting the disaster loans processed properly and the belief that this might serve disaster victims better.

I have gone over this with some people in your organization and with members of the ABA. Some of the bankers are in favor of it. I will be pushing the bill. I think that this is generally in line with the philosophy that you are proposing.

I found last year that it was difficult to work with some SBA officials and the OMB because the party line was to get rid of the agency. That now has changed. I am wondering whether you have had a chance to look at that proposal and whether you are viewing it favorably, and whether you would like to work with me on it.

Mr. **Heatherly**. I think, Congressman, that we are interested in it in principle and in concept. We are in favor of more involvement of the private sector. And obviously, in our other loan programs, we are giving greater and greater emphasis to bank participation versus direct loans.

We think that the concept has merit. The practicalities of it though are very difficult. As you will recall, our staff did give your staff some technical assistance in the drafting of that bill, and answered questions and so forth.

Mr. **Olin**. Yes; I appreciate that.

Mr. **Heatherly**. We have some reservations about the practicalities of it in the case of large disasters. Whether the banks would be willing and able to move that quickly in those situations. But we are interested in pursuing the subject with you, and trying to work out some of the practical difficulties.

Mr. **Olin**. I would appreciate that, and I think that is consistent with your desire to sell that loan portfolio. If you get the portfolio sold, you do not want to be creating new portfolios at the time that you are trying to sell the old. It would not make too much sense.

Mr. **Heatherly**. There is a great deal of frustration experienced when the disaster hits and people want and expect assistance, and it takes quite awhile to get that paperwork done because it is a loan. It is not a grant or a gift. And there are certain requirements that we have to go through and certain documentations we have to go through.

Mr. **Olin**. Mr. Heatherly, I can tell you for absolutely certain that——

Acting Chairman **Skelton**. Let me say that your time has expired.

Mr. **Olin**. Thank you. May I have a little time perhaps in a later round, Mr. Chairman?

Acting Chairman **Skelton**. You bet. Mr. Gallo.

Mr. **Gallo**. Thank you, Mr. Chairman.

I would first like to thank you, Mr. Heatherly, for appearing before this committee today. I am pleased with the administration's decision to hold the budget at the same. We have been going over the fight of termination of this department, and I am pleased that there has been a change in philosophy.

I do have, however, some concerns about the proposal for small business development centers, as indicated by many of my colleagues. The SBDC's in the State of New Jersey were very instrumental in a number of areas that showed some obvious success.

I had a very successful conference which brought small business into areas where they would not be, otherwise. There was a great deal of expertise shown by that group. We had over 340 small business people attend the seminar, which was highly successful, and received a great deal of credit for getting people involved in procurement both on a State and Federal level. So it is a very successful group in the State of New Jersey.

Under your proposal, how many SBDC's in how many States would be at their cap, and thus taken or phased off the program with the reduction in the amount from the $65 million to the $45 million that you are talking about?

Mr. HEATHERLY. Well, all of the States would eventually phase out of the program. The number of States that are at their cap today—John, do you know the figure? It is a significant number, 15 or 20 I believe already at their cap and would begin the phaseout next year and complete it in 3 years.

Mr. GALLO. I was given a figure, and I am not sure whether it is correct, but 26 States would be affected, which would mean that they would then be subject to a 5-year phaseout, is that the projection?

Mr. HEATHERLY. Those that are at the cap already would be subject to a 3-year phaseout.

Mr. GALLO. A 3-year phaseout. My concern is that a lot of these programs are just taking hold now in the States. The State of New Jersey I think, if I can use it as an example, has really got a great deal of expertise. We are not at the cap, and therefore would not be affected on a 3-year basis, but certainly would be affected on a 5-year basis.

When we have put such a great emphasis on creating opportunities for small business, I think that it can be classified as shortsighted if we are going to reduce this particular area, as I classify it as one of the most important areas to get our small business community involved in—broadening their horizons and also making them much more viable.

Is there any fear from you or members at the table that the reduction will have an adverse effect?

Mr. HEATHERLY. Congressman, I think that this will vary from State to State depending upon the effectiveness, the reputation, and the support levels for those systems within the State, the track record, the perceptions within the business community, the quality, the programs, the willingness of the Governor and the State legislature to continue or expand support. I think that that is a State-by-State decision, as it should be.

We have never said, the administration has never said, that the SBDC's do not do some valuable work and some worthwhile work in management and technical assistance. What we have said is that we do not believe that this is an appropriate Federal role indefinitely.

It was originated in the late 1970's as a seed money project to help these things get started. And I do not believe that it was conceived that it would be a permanent investment or a permanent operating requirement of the Federal Government.

And at the time that this program was started in the late 1970's, we had a very generous Federal Revenue Sharing Program which now has been terminated. I think that is symbolic of the fact that the Federal Government no longer has revenues to share, but we only have deficits to share.

Mr. GALLO. Thank you, Mr. Chairman.

Acting Chairman SKELTON. Mr. Mfume.

Mr. MFUME. Thank you very much, Mr. Chairman.

Mr. Heatherly, I, too, like a few of my colleagues was not here when you gave your opening remarks before the committee. I have the testimony, and I promise that I will go through it in great detail. I have one question though concerning the proposed transfer—or maybe I have two.

First of all, how do you expect, in the thinking for the agency, to carry out the same level of service to minority businesses that has been provided by the MBDA?

Mr. HEATHERLY. Well, we will be bringing the minority business development centers, which are the front line delivery of those services, we will be bringing those over here intact to the SBA, all 100 of them, to be administered by a new field structure that would merge the two present field structures together while eliminating some duplicative overhead in the central office.

The reductions that are being recommended and carried out are in overhead functions, administrative and support functions, not out in the field per se.

We asked the MBDA when we were developing this budget proposal what percentage of your field structure and your field personnel are devoted to the support and maintenance of those 100 MBDC's, and they said 81 percent. And that is the figure that we picked; 81 percent of the field is being transferred.

There may be some adjustments made, because we have a standard 10 regional field structure where they have 6. So there will have to be some adjustments made when you merge the two organizations.

But we are convinced that by putting the two together that we could have a much stronger, more visible, and more effective impact on the minority business community than the two organizations have separately.

Mr. MFUME. You do not see the two organizations as having an adversarial relationship?

Mr. HEATHERLY. No; I do not. I see them as having a complementary relationship.

Mr. MFUME. Is it not true then that SBA's chief role is as an advocate for small business, and as such it places it in an adversarial position in many instances against major corporations, State and local governments, and many of the procuring Federal agencies; while on the other hand MBDA serves basically in the interests of minority businesses in a role that oftentimes establishes close relationships with major corporations and in the private sector?

Mr. HEATHERLY. The SBA and our MSBCOD Program do not have an adversarial relationship with major corporations or other agencies. We have no authority over them. What we get from them is through cooperation and negotiation.

Our program has two parts, the contract assistance or the set-aside program which is administered by one part of the organization, and our 7(j) or management and technical assistance effort which is administered by a different part of the organization.

We are talking about the merger of MBA and MBDC's with our 7(j) program that would not directly impact what we are doing in the contract assistance or the set-aside program other than perhaps getting the two to work together a little more closely. But we do not see these as adversarial relationships.

Mr. MFUME. When did the marriage occur between SBA and major corporations and State and local governments?

Mr. HEATHERLY. Well, there are many major corporations, Ford Motor Co., General Dynamics, Northrop, many major corporations that are defense contractors, NASA contractors and others who are doing a terrific job in the subcontracting area with minorities on their own initiative.

They have offices and programs set up, and our procurement assistance people and our 8(a) people work very well with these major corporations in stimulating and expanding the subcontracting dollars that are going to minority firms. We do not see this as adversarial.

Mr. MFUME. What is the level of funding for MBDA, is it about $40 or $45 million?

Mr. HEATHERLY. In total, it is about $40 million.

Mr. MFUME. And you can absorb that total loss?

Mr. HEATHERLY. No; we are transferring it, Congressman. We are transferring the majority of it with the transfer of the agency. We are not absorbing it.

Mr. MFUME. But you would be absorbing it if you did away with the other things that you are proposing this morning.

Mr. HEATHERLY. We are transferring about 80 percent of it to SBA, dollars and people.

Mr. MFUME. More than 92 percent.

Mr. HEATHERLY. And merging it.

Mr. MFUME. And the other 92 percent?

Mr. HEATHERLY. I said 80 percent, 80 percent.

Mr. MFUME. But that is still counting the costs that you are proposing without those cuts.

You are really absorbing it, are you not?

Mr. HEATHERLY. We are absorbing mergers of overhead functions. We are not absorbing any program cuts.

Mr. MFUME. Thank you, Mr. Chairman.

Acting Chairman SKELTON. Mr. Hefley.

Mr. HEFLEY. Thank you, Mr. Chairman.

It seems that maybe my colleagues at the table here today have accepted the fact that you are going to be in existence. The chairman, in his opening remarks, said that that is no longer a subject for debate. I guess that I do not see it quite that way. I think that it is still a subject for debate.

I think that with that kind of deficit that we have that there is not an agency of Government that is not too sacred to consider whether they ought to exist any more or not. And I think that there have been some problems with the SBA, and hopefully you are trying to correct them.

So maybe this maintenance budget is a good way to go to find out if you do. But I think that if you do not, then we have to take a hard look at whether it ought to exist.

One of the things where there is an increase is in the surety bond area in your budget. I guess that there was a shortfall in fiscal year 1986.

What is the reason for that shortfall?

Mr. HEATHERLY. Well, the demand on the program. We ran out of money in August, and we had to basically close it down for 6 to 7 weeks. And that happened the previous year also I believe in 1985.

So we are agreeing that there is a demand for more guarantee authority or more guarantee funds available. But we are offsetting that with some increased fees, user fees, for the people who are directly benefiting from the program. We believe that those fees are reasonable and will help offset the increased costs of the program.

But we do recognize that there is an increased activity out there in terms of the contracting activity that needs this bonding, and we are recognizing that and increasing the guarantee levels accordingly.

Mr. HEFLEY. Was there just an increased demand on the fund, or was there more defaults?

Mr. HEATHERLY. No; it was demand levels.

Mr. HEFLEY. Do you think that this amount that you are proposing to increase will carry you to the end of the year then, next year?

Mr. HEATHERLY. To our best judgment, yes, Congressman, it should.

Mr. HEFLEY. OK, thank you.

Mr. HEATHERLY. The $200 million increase is about a 20-percent increase in the levels.

Mr. HEFLEY. Thank you.

Acting Chairman SKELTON. Jan Meyers.

Ms. MEYERS. Thank you, Mr. Chairman. I am sorry to be late. I had another hearing, and will be going back and forth.

I noticed that on page 12 of your testimony that you comment on the National Advisory Council International Trade Committee, and that you are going to hold a joint meeting with them. I would like you to comment on what we can do through this committee to encourage competitiveness, and to assist small business people in international trade.

How do you see the Small Business Administration as helping with this effort, will you work with Commerce, what do you see as the principal needs there and how do you propose to proceed with that?

Mr. HEATHERLY. Congresswoman, I have also attached to my testimony, as one of the appendices that is burdening your desk there, a list of our program goals with international trade for the year, concrete goals that we are trying to achieve.

Our basic strategy is to avoid duplicating what the Department of Commerce, or the International Trade Administration or other agencies are doing, but rather to take on as our mission making sure that the small business manufacturer or other small business concern that has an interest and capability has access to that information and that assistance that is being provided through other agencies.

We do this by publications and we do this through conferences and workshops, and by working with State and local chambers that are sponsoring conferences and meetings.

We are participating, for example, in a major conference this spring cosponsored by the State of Illinois, and the economic development people in the Midwest. International trade plus technical advice and management assistance, will be one of the principal tracks, one of the four principal tracks, for that conference. And we are participating in the promotion and marketing of that as well as with some speakers.

So we see the agency as a broker and a link to reach the small business community and reach those firms that have an interest and a potential, and link them up with the resources and the expertise that exists, and help them understand the requirements for participating in the international trade, and help them access that market overseas.

It is not a simple thing. If there is one magic solution to it, we would have done it already. It is difficult, because there are first of all psychological blocks. Many people who have the export potential are not thinking of it, because they have a perception of it as being just something that is beyond them and that only large firms do, which is not necessarily the case.

There is also a great deal of inhibition in dealing with the Federal Government and Federal agencies to get the permits and so forth that may be required.

We see that we have a complementary role with Commerce's International Trade Administration and other agencies and a brokering role, where the small business people can feel comfortable coming to our district offices or our field offices and asking questions, and that we can then help direct them to the answers or can plan workshops and conferences that can bring experts together to answer those questions.

It is something that we are putting a priority on this year. We have a very active committee of our International Trade Committee of our National Advisory Council that is putting a lot of thought into this, and we are getting those private sector people together with our own program staff to try to improve our operating plans and make some long-range plans that will be ever more exciting.

Ms. **Meyers**. I know that Commerce feels that some of the problems are right here within our own Government, not the problems of accessing foreign markets. And they have to deal with such things as tort reform, and merger laws, and vague bribery laws.

And it seems to me that if everyone who has an interest in competitiveness would be working together to try to work with the changes in our laws that are necessary, that that might be helpful. Rather than just having one voice speaking about this, I think that it is important that all of the business voices are speaking together to get the necessary changes made.

Mr. **Heatherly**. And those impediments affect all businesses, large and small, but are more of a problem for small businesses in most cases.

Ms. **Meyers**. Thank you, Mr. Chairman.

Acting Chairman **Skelton**. Mr. Lancaster, I did overlook you a moment ago.

Mr. **Lancaster**. No questions.

Acting Chairman **Skelton**. No questions. All right, sir. Mr. Combest.

Mr. **Combest**. Thank you, Mr. Chairman.

Mr. Heatherly, I apologize for being late. Not having heard your opening statement, if in this information which we have, you see my question leading to an answer which is there, please direct me to that, and I will save the time of the committee.

In my prior life as a small businessman starting a business, I received a guaranteed loan through SBA. It was extremely helpful to me in getting started in that business. Therefore, I have a very personal interest in this program and the continuation of the Small Business Administration. Because I know also in my home of Lubbock, TX, and in other areas in the 19th District, that a lot of people have received help. It was the only way that they could have got going. We have very successful businesses now that are operative there.

What dollar amount in the last year that you have completed figures for, did you participate in guaranteed loans?

Mr. **Heatherly**. Our dollar amount in the 7(a) guaranteed loans was about $2.4 billion. That was our guarantee.

Mr. **Combest**. Your guaranteed portion?

Mr. **Heatherly**. Our guaranteed portion.

Mr. **Combest**. Was that in fiscal 1986?

Mr. **Heatherly**. Fiscal 1986.

Mr. **Combest**. What percentage of those—well, that would not be a fair question, because some of those are still going to be going on for several years.

But normally as an average, and this may be just kind of a ball park figure, but normally what is the percentage of loss that actually is incurred?

Mr. **Heatherly**. We use different definitions of loss.

Mr. **Combest**. When you have to go in and pay them off.

Mr. **Heatherly**. The ultimate loss rate, which I think is the most meaningful figure, now stands at about 13 percent. In other words, if we make $1 billion in loans this year over the life of that portfolio where all of them are paid out, we would experience a $130 million loss at 13 percent if nothing changes, if we continue current practices, and if the servicing remains the same and so forth. We are working very hard to bring down that loss rate not only at the front end in terms of quality lending and the indicators for quality loans and enforcing the policy of this administration which has been in place since the beginning which is really a matter of implementation of the quality lending concept. But there is also the servicing end of it and giving assistance to businesses that may be in trouble, and to bring them back into a normal repayment schedule. We are working very hard to bring down those loss rates. But at the present time, they are about 13 percent in total over the full life of the portfolio.

Mr. COMBEST. The assistance, which is also provided through SBA in common types of programs that you get involved in, in giving management assistance and so forth to businesses, I think is also extremely good.

We are, in Texas and I am sure in a lot of other areas of the country as well, experiencing, as you know, some pretty tough economic conditions. Consequently, your normal lending institutions are coming under extremely close scrutiny by the comptroller or whoever that regulatory agency may be.

We certainly do not want to encourage bad lending practices by financial institutions or by the Government. But I think that we are going to be seeing an increased need, simply because of a lack of venture capital and other types of capital, of participation in loans in order to allow small business, simply because banks cannot totally make their own decisions at this time.

They are not really the ones who make the decisions of whether they are willing to lend money. It is pretty much the Federal regulators who are making that determination for them. And they are certainly looking at a very high potential of having a lot of loans classified that otherwise they would like to continue on the books.

I just wanted to say for the record that I think that the program has worked well in many of those areas, and again some of that from personal experience, but as well, I feel like we are going to see a continued need increase at least in my part of the country over the next several years. Hopefully, not. Hopefully, the economy will turn around where it will not. But that is, basically, the only funds and the only resources that many of those individuals have.

Thank you. Thank you, Mr. Chairman. I yield back.

Acting Chairman SKELTON. Thank you. Mr. Upton.

Mr. UPTON. Thank you. I apologize for being late as well. I will look at your statement with a great degree of scrutiny. I will follow up on Larry's comments and questions with regard to the 12 percent rate of default.

Is it about the same amount between guaranteed and direct loans that you have had in the past?

Mr. HEATHERLY. No; our experience with direct loans is much different. We have about a 21-percent loss rate on direct loans which is understandable. We do accept higher risks at the beginning. We acknowledge that, and it is inevitable that there are going to be higher loss rates on those loans.

Over the course of this administration, we have, in cooperation with the Congress, brought the percentage of our lending in the direct program down. The proportion has come down.

We are doing now about 98 percent of our loan volume that is now in the guarantee portfolio last fiscal year. But the 2 percent is still there, and obviously it is still important for the firms that are benefiting from it. We would prefer to eventually get out of the direct loan business entirely and utilize the guarantee programs.

Mr. **Upton**. When a company defaults, what is your normal percentage of recoupment? Are you able to work with IRS?

Mr. **Heatherly**. If we go into liquidation of a loan, we would get about 40 percent, 40 to 50 percent maximum recovery depending obviously on the individual case. But those figures are taken into account in the loss rates. They include the recoveries.

Mr. **Upton**. Thank you, Mr. Chairman.

Acting Chairman **Skelton**. Thank you. I have a couple of questions, but I believe that Mr. Ireland has a request at this time.

Mr. **Ireland**. Mr. Chairman, in the absence of our ranking member and one or two of our other members who were not able to be here, we have a number of questions that we would like to be able to submit for the record. And if we could have until say noon on Tuesday to submit those?

Acting Chairman **Skelton**. Without objection, members of this committee will have until noon Tuesday to submit questions. We would appreciate the answers as part of the record.

Mr. **Ireland**. Thank you.

Acting Chairman **Skelton**. I have a couple of questions. I would like to refer to the part of the statement regarding the sale of assets. In this portfolio which you propose to sell, you have disaster loans, business loans, 503, regular SBIC, MESBIC debentures, MESBIC preferred stock.

First, who in the world is going to buy these things?

Mr. **Heatherly**. Well, of course, you will not know for certain until you offer them, but there does seem to be quite a bit of interest on the part of the investment community in these assets sales, not only at SBA but other agencies.

Acting Chairman **Skelton**. Is it not true that if you did not sell these that in all probability based upon your experience that you would end up by regaining some 90 percent of these plus interest, is that not correct? Has that not been your experience in the past?

Mr. **Heatherly**. Well, it varies from portfolio to portfolio.

Acting Chairman **Skelton**. I understand that, but I am looking overall.

Do you not have about a 90-percent recovery record plus interest?

Mr. **Heatherly**. 85 to 90 percent.

Acting Chairman **Skelton**. Which is pretty good, is it not, based upon the fact that these are not Grade A loans all the way across the board, is that not correct?

Mr. **Heatherly**. I do not think that many banks could survive that record. But for a Federal agency, it is probably pretty good.

Acting Chairman **Skelton**. Now you do not expect to get anything like 85 or 90 percent of these loans, do you?

Mr. **Heatherly**. No, sir.

Acting Chairman **Skelton**. More like 15 cents on the dollar?

Mr. **Heatherly**. No, sir.

Acting Chairman **Skelton**. What about 50 cents on the dollar?

Mr. **Heatherly**. Well, 50 cents would probably be max in some of the cases.

Acting Chairman **Skelton**. What would you average for all of these, 40 cents on the dollar?

Mr. **Heatherly**. We do not know. That is why we are asking a financial advisor to come in and tell us for each portfolio what we can reasonably expect.

Acting Chairman **Skelton**. Suppose you get 45 cents on the dollar. You are losing about 45 cents on all of these sales plus interest, is that not correct?

Mr. **Heatherly**. Well, I think that the interest cuts both ways. We would have that money for that average 10-year life of that loan. The Government has the use of that money rather than having it repaid in the interest.

Acting Chairman **Skelton**. Are there not some of these categories that you would be doing well if you got 15 cents on the dollar?

Mr. **Heatherly**. Well, I think that those estimates that were made last year and 2 years ago when these portfolio sales were first proposed, that there were some ball park estimates made by OMB that are included in our proposal, and some of the direct loans would be in the neighborhood of 14 or 15 percent.

I think that that is a lot of conjecture and speculation, and it depends on the life of that portfolio, and how we might segregate it out. There might be some loans, Congressman, that we would decide not to sell.

Acting Chairman **Skelton**. To make a long story short, I would be very interested in seeing what proposals come along. I will be following that when it happens.

We are just about ready to close our hearing, and we have the gentleman from the State of California.

Do you have questions, Mr. Dreier?

Mr. **Dreier**. Well, thank you very much, Mr. Chairman.

Obviously, I have missed the testimony, and I do not know what kinds of things you have covered. But I would like, if we have got just a few minutes, to just ask Mr. Heatherly if he could give me his thoughts briefly about the transition which has taken place from the package that he and I had worked on last year to transfer and eliminate the Guaranteed and Direct Loan Program, and transfer the very beneficial aspects of the SBA to the Commerce Department.

I do not know if you have gone through all of that, Mr. Chairman. But if he would just like to offer me a couple of minutes of thoughts on that, I would appreciate it.

Mr. **Heatherly**. Congressman, we would prefer to focus on the future rather than the past in our budget.

Mr. **Dreier**. Well, I think that I am trying to talk about the future, Chuck. I would like to know exactly where we are going from here based on what we worked on over the last several years.

Mr. **Heatherly**. The concept as embodied in the budget is a recognition of the desire on the part of the Congress to continue the 7(a) program. And that continued proposals to eliminate the program are not going to be successful, and that we are going to accept the continuation of the 7(a) program. Although for reasons which were well explained in the past 2 years, philosophically, we think that there are reasons why we should get out of the loan business entirely.

But if we are going to continue this 7(a) program, the guarantee program, with its benefits, there are things and there are steps that we can take to reduce its total cost through the increased loan fees and better servicing within the agency, more emphasis on the bank participation, increase the percentage of bank participation.

We think that we can take those steps to bring down the cost of the program and to improve the quality of the loans, and therefore maintain the program on an acceptable basis.

Mr. **Dreier**. You indicated that you do not see an elimination of 7(a) in the future.

Is that looking off into the distant future, or is that still something that you would like to see obtained at some point?

Mr. **Heatherly**. My understanding, Congressman, is that after 6 years in Washington that long-range planning is a 2-year process.

Mr. **Dreier**. Well, I just completed 6 years, too, and have come to that conclusion, but I still like to think about the future.

Mr. **Heatherly**. I cannot conjecture or speculate about what the long range may bring under different circumstances. Looking at this in 2 years, I do not foresee proposals to eliminate the 7(a) program.

Mr. **Dreier**. Thank you.

Acting Chairman **Skelton**. Thank you, Mr. Dreier. And Mr. Heatherly, I thank you so much for being with us. I am sorry that Chairman LaFalce, could not be here, and I know that you understand the reason that he is absent.

Mr. **Heatherly**. Yes.

Acting Chairman **Skelton**. Thank you so much. The meeting is adjourned.

[Whereupon, at 10:34 a.m., the committee adjourned, subject to the call of the Chair.]

FISCAL YEAR 1988 SMALL BUSINESS ADMINISTRATION BUDGET

WEDNESDAY, MARCH 4, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 9:10 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce, (chairman of the committee) presiding.

Present: Chairman LaFalce; Representatives Smith, Skelton, Sisisky, Bilbray, Mfume, Flake, Lancaster, Campbell, McDade, Slaughter, Meyers, Gallo, Rhodes, Hefley, and Gallegly.

Chairman LaFalce. The Committee on Small Business will come to order. This morning we resume our hearings on SBA's budget for fiscal year 1988. These hearings commenced last week with testimony from SBA's Acting Administrator, Charles Heatherly. I want to note at the outset that due to the death of a very close personal friend, I had to return to Buffalo the night before Mr. Heatherly's appearance, and I was unable to attend the hearing. I want to thank Mr. Skelton for chairing the hearing in my absence.

Subsequently, however, I have reviewed Mr. Heatherly's statement, and regrettably it does not answer my concerns about the administration's budget. In fact, it underscores them. There are many items in Mr. Heatherly's statement with which I take issue. But if I did so on each of them today, we would not have time to hear from our witnesses.

Therefore, let me simply reiterate a point that I have already made to administration officials in private discussions. Congress will reject any attempt to dismember the SBA, program by program, just as it rejected the administration's proposals of the previous 2 years to eliminate the SBA all at once.

I certainly join with the administration in its professed concern about budget deficits, and the need to reduce nonessential programs wherever possible. However, it is also clear that the administration, given its 6-year track record on deficits has a very selective concern when it comes to budget cutting, and the SBA has been one of its favorites.

I believe that small business has already contributed much more than its fair share to budget reduction.

In 1980, direct loans provided almost $400 million to small businesses which were unable to obtain financing from any other source. By 1987, this program had been cut 75 percent in nominal dollars.

In 1980, loan and debenture guarantees totaled almost $3.2 billion. By 1987, this program was actually 1 percent lower.

In 1980, surety bond guarantees totaled over $1.5 billion. By 1987, this program had been reduced 29 percent nominally.

In 1980, pollution control bonds totaled almost $100 million. By 1987, this program had been reduced by 24 percent.

What does this mean in terms of outlays? Excluding those for disaster loans, non-recurring items such as the White House Conference and sale of assets, and new user fees, in 1980 SBA outlays were approximately $950 million. By 1987, however, this level had been reduced by more than one third, and for 1988 the administration is proposing an additional decrease of 10 percent over the base line.

At the same time, total Federal outlays were increasing from just under $600 billion in 1980 to more than $1 trillion estimated for this year. Thus, if other agencies had contributed even a fraction of the proportional reductions borne by the Small Business Administration, we would have a balanced budget today.

And now the administration wants to eliminate direct loan assistance to the handicapped, to minorities, and to disabled and Vietnam era veterans. It also wants to eliminate the pollution control contract guarantees program and wants to phase out the Small Business Development Center Program and make substantial changes in the guaranteed loan program and others.

I believe that this committee is going to say enough is enough.

I am delighted with the array of witnesses that we have appearing before us today and tomorrow, and I anticipate that their testimony will be much better and more to the point than that received from the administration.

Mr. McDade. Mr. Chairman, let me just join you in welcoming our witnesses in front of the committee. We are very grateful to them for taking time to be with us today and tomorrow and to give us their views with respect to the budget that we are looking at. We have, as usual, a lot of difficult decisions to make as a committee, as a community if you will, as a small business community and as a nation.

And I have every confidence that as we go through that procedure in this committee, we will work together to achieve the best possible results that we can, and so I welcome you. We are delighted to have you. I commend the chairman in calling in the panels of witnesses, and we look forward to your testimony. Thank you very much, Mr. Chairman.

Chairman LaFalce. Do any other members have statements that they would like to make at this time?

[No response.]

Chairman LaFalce. All right. Thank you. Before we proceed, the staff had scheduled three panels, and we have the individuals from the first panel at the table right now, Mr. Shattuck, Ms. Price, and Mr. Carroll.

Is Mr. Purdy here?

Mr. Purdy. Yes.

Chairman LaFalce. Is Mr. Croxton present?

Mr. Croxton. Yes.

Chairman LaFalce. Mr. Magnotti?

[No response.]

Chairman LaFalce. Mr. Thomas?

Mr. Thomas. Yes.

Chairman LaFalce. All right. I would ask all of those witnesses who are here to please come to the table. And the one representative who is not here, I will ask him to come to the table, too.

It has been my experience that very often that members of committees or subcommittees find time within their schedule to listen to one panel, and then virtually no one is here for panel two and panel three. So to the maximum extent possible, we will attempt to have one panel if we can.

This will also mean that in order to afford the members the time to ask questions of the panel that two things will be imperative. Number one, that the members attempt to confine themselves to the five-minute rule. And number two, that witnesses attempt to give their verbal presentations in approximately five minutes, although we will put the entirety of their remarks in the record.

With those brief guidelines, we will call upon the president of the Smaller Business Association of New England representing National Small Business United, Mr. Lewis Shattuck.

TESTIMONY OF LEWIS A. SHATTUCK, PRESIDENT, SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND, INC., WALTHAM, MA, REPRESENTING NATIONAL SMALL BUSINESS UNITED, WASHINGTON, DC

Mr. Shattuck. Thank you very much, Mr. Chairman. First, I would like to congratulate you on your new chairmanship of the committee. As a member of the committee through the years, you have been a champion and a real advocate for small business on the floor and in the committee, and we look forward to working with you.

Second, I want to tell you how pleased we are that the committee was able to save the SBA. Many of you here today were advocates for saving the agency, and I am very pleased.

I suppose the first comment to make regarding the fiscal year 1988 budget is that it is the first time that the SBA has a budget in three years, and certainly that is good news. On the other hand, we believe that the budget is defensive and apologetic for an agency that since 1953 has had significant achievements in providing assistance to small business.

It is ironic based on the 1987 and 1986 budgets which folded SBA into Commerce that this budget has a portion of the Department of Commerce, that is the Minority Business Development Administration, merging into SBA.

Mr. Chairman, I would hope that this would be the first step in SBA's eventual takeover of all of the Department of Commerce's responsibilities. An SBANE member several years ago recommended that the SBA take over Commerce, because after all SBA represents millions of small companies and Commerce represents basically a few large ones. I take that such a takeover is no less appropriate today.

Chairman LaFalce. Has anyone introduced that bill for SBA's takeover of Commerce? I was just wondering.

Mr. McDADE. Mr. Chairman, I was going to say that I thought we were doing pretty good to keep the agency independent.

Chairman LAFALCE. I think that we ought to go on the offensive.

Mr. SHATTUCK. Mr. Chairman, there is a new book entitled Small Business USA by Steven Solomon that describes the role of small companies in sparking America's economic transformation. I commend this book to you and to other members of the committee. This country is in an entrepreneurial boom with some 1.5 million startups being formed annually.

The SBA has been a key factor in encouraging the formation of new business, creation of jobs, and saving the Federal Government nearly $400 million a year through competitive procurement. The SBA has made the difference between success and failure for hundreds of thousands of small businesses since its inception in 1953.

With such an enviable track record on behalf of small business, why should the fiscal year 1988 budget be calling for further cuts when it can be proven that the agency has more effective programs for economic development than any other agency in the Government.

The 1981 SBA outlay was $1.9 billion. In 1986, it was $714 million with a 26-percent reduction scheduled for fiscal year 1987 and another 28 percent in fiscal year 1988.

Under the able leadership of Administrator James Sanders from 1981 to 1986, the resources of this agency were leveraged with the private sector wherever possible. Productivity increased while manpower was decreased. Banks became more integrated into the SBA programs as did universities, and the percentage of small business Government contracting was bolstered by adding more people which brought enormous savings in government procurement.

The fiscal year 1988 budget reduces the agency's ability to perform services at an alarming level. I have the following comments regarding the credit program:

If you want to raise the general business guarantee fee by 2 percent and add 1 percent for the banks and lower the guarantee from 90 to 75 percent, bankers and SBA people that I have talked to say that this will virtually drive the SBA out of the lending business totally.

We do, however, very much appreciate the fact that in the credit area that the surety bond program would be increased. This is a very popular program. It is doing the job that it intended to do by making the construction industry more competitive.

We do not understand, however, why the agency is recommending selling off its loan portfolio at a fraction of what it could get. These are collectable receivables. I do not think that you have to sell them off.

We also are concerned about what driving down the guarantee would do to the SBIC industry which has been so effective helping small businesses since 1958.

In terms of Small Business Development Centers, it is a well known fact that over 50 percent of all business failures are due to lack of sound management practices. The administration's activities providing management assistance has evolved through the years to where the most effective mechanism in business development can be obtained through the Small Business Development Centers.

It is an ideal example of a Federal/State partnership providing small business with access to expertise and knowledge that is not available elsewhere. The agency estimates that for every dollar of Federal funds appropriated that the return to the small business sector is $1.46. And this is by using local resources.

The Business Development Division just in the Boston district office alone assisted over 28,000 small business owners through counseling and training.

The SBA implemented SBDC legislation in 1977. It was my pleasure to testify on the Senate side when the SBDC's were formed. The popularity of the SBDC Program today speaks for itself. It has exceeded everyone's imagination. To reduce the program and eventually phase out Federal funding is a serious mistake.

Without SBDC's, the SBA would have no effective business development function. It is only logical that this agency be able to back up its lending program with opportunities for small business to receive training and counseling. SBDC's have played a significant role in the entrepreneurial drive this country is experiencing. They should be expanded, not shrunk, because they do the job and they do it well.

And last, Mr. Chairman, the buzzword in today's Washington is global competitiveness. Trade associations, economists, and Members of Congress are expressing grave concern about our ability to compete in the world market or in any market with increasing imports coming into the American marketplace.

The SBA has long been looked upon by the rest of the world as a model for how a country should encourage and assist small business. At one time, the SBA was the only Federal agency in any country to help small business.

It is no longer the only one. Other countries have come together with excellent programs to help the small business sector. We have lost our leadership role in helping our own small businesses.

As you read Mr. Solomon's book, you will see enormous attention being given to small business, not only throughout the free world, but even a significant small business trend in Communist countries as well.

In fiscal year 1986 and 1985 combined, the Office of International Visitors at the Small Business Administration conducted 290 briefings for 853 visitors from 113 countries. The best way that we can reach our potential in America's competitiveness is to strengthen and encourage those agencies involved in economic development and the nurturing of enterprise.

The NSBU supports a strong and viable Small Business Administration. Mr. Chairman, I thank you and the members of this committee for this attention to the budget, and I hope that these hearings will lead to a stronger agency on behalf of the millions of small businesses that can contribute so much to our economic vitality. Thank you very much.

Chairman LaFalce. Thank you, Mr. Shattuck. Our next witness will be Ms. JoAnn Price, Chairman of the Board of Directors of the Small Business Legislative Council. Ms. Price.

TESTIMONY OF JOANN H. PRICE, CHAIRMAN OF THE BOARD OF DIRECTORS, SMALL BUSINESS LEGISLATIVE COUNCIL, WASHINGTON, DC

Ms. PRICE. Thank you, Mr. Chairman. And we also would like to add to Mr. Shattuck's comments of congratulations on your new chairmanship to the House Small Business Committee. And of course, we look forward to working with Mr. McDade, as we have done in the past.

My name is JoAnn Price, and I am chairman of the Small Business Legislative Council [SBLC]. The Legislative Council is a coalition of over 90 small business trade associations from across the country. They include such groups as the national grocers, the moving and storage, the brick distributors, the specialty tool manufacturers, the plumbing, heating and cooling manufacturers, and it goes on and on.

We feel as an organization that we reach out to the wide range of business organizations, and we are looking at a variety of issues that small business people face every day. Coincidentally, we just finished our annual meeting. And during that time, we have come up with 30 recommendations of priority in our community and within our Council.

And of course, one of those priorities this year will be the strengthening and maintaining of the Small Business Administration.

To briefly touch upon the areas, of course, that we think are most important, they include and they have included in the past when we were before your committee in the last two budget years that we want to maintain a strong Small Business Administration.

Number one, we are very concerned about strengthening the advocacy program at SBA. That has always been one of our biggest concerns at SBA, and we want to make sure that the advocacy program is maintained and is strengthened.

We feel that their management and technical assistance programs are very important. The Small Business Development Center concept, we hope will be maintained and strengthened in the future. We feel that the State partnership along with the Federal Government has been a very effective one.

In addition to that, we hope to maintain and strengthen the Small Business Investment Company Program. And needless to say, SBLC is a strong supporter of the establishment of the corporation of small business investment which we think will be a unique continuation of the private public sector role of the SBIC Program as we move into the 100th Congress.

One additional comment on the small business is that we feel that the Small Business Administration has been under the budget cut for two years, and we feel that they have made the necessary sacrifices. At this point, we feel that proposals on user fees and other types of ways to exact an additional cost on the small business person is not only preposterous, but we think that it is unreasonable.

So we hope that the committee will maintain the Small Business Administration in its present form, and that we will not have to deal with any additional cuts at this point.

While we have the opportunity to be before you today, we would like to also outline the Small Business Legislative Council's other top priorities. You obviously see that we have a 30-page statement, and we are going to submit that for the record, but I would like to outline briefly the other priorities of the Council for the 100th Congress.

We feel that the Small Business Committee should be a window for the small business community across the country, and we also think that there are other issues that do not necessarily fall right within your jurisdiction, but are certainly issues that are key to the success, the survival and overall viability of our community.

The number one priority of SBLC in the 100th Congress is our opposition to mandated benefits. These benefits cover a spectrum of initiatives from personal, from parental leave to health insurance. Small business objects to such mandated benefits not only the basis of the cost, but also because they inhibit management flexibility.

In a small business, such flexibility can make the difference between success and failure. The emergence of a concept of mandated benefits is very disturbing to our Council. We believe that it is indicative of a trend to push more of the responsibility of social goals upon the shoulders of small business.

Small businesses certainly are more dependent on each employee for the overall success and smooth operation of the business. We also believe that small business assumes its share of responsibility to the community and to society. At what point will we reach the breaking point for small business?

In addition to mandated benefits, there are also new discussions on increasing the minimum wage, passing stringent employee notification laws, and banning the use of polygraphs to name a few. Needless to say, SBLC members will be testifying all over the Congress this year on this particular issue.

Our second recommendation represents our views on tax policy for small business. We are not fans of the Tax Reform Act of 1986. And in this recommendation, we have attempted to establish what we view to be an appropriate taxation and capital formation policy which will promote the growth of small business.

Our third recommendation cites the need for comprehensive tort reform and the passage of uniform liability legislation. While the tort reform insurance regulation crisis may be ebbing, the systematic flaws remain and we must address them.

Our fourth priority is enactment of further spending reductions and tough laws to create the balanced budget reduction process. And we are talking about, of course, one that works.

Our fifth recommendation calls for reforms of the insurance industry regulation process. Small business recognizes that all sides were to blame for the recent crisis. If we do have affordable available insurance in the future, we must do more than revise the civil justice system, and we must provide for a sophisticated regulatory scheme equal to the task of managing global industry.

I would like to mention just a few other recommendations of our issues conference. International trade was a significant concern, Mr. Chairman. And as we know, you have been a supporter of our industrial sector to be able to compete on a competitive level in a world marketplace.

The problem has reached obviously a critical mass. And at a minimum, we need to help shape small business and allow them to gain greater access to the export markets. And we hope to work with you when you hold hearings later this month.

Looking to the future, we are not as confident about the status of small business in the economy in the year 2000. It will be more than a year before we feel the effects of the Tax Reform Act, and it will certainly be many years before we feel the full impact.

In our organization, there was considerable opposition to the bill when it was passed. One specific concern expressed at the time was the disproportionate and negative impact of the bill on small corporations. These are the firms which constitute the innovation and the job creation sector of the economy, and they are the firms that must go head to head with the mega firms. We, of course, will be working on that during the 100th Congress.

Our full list of recommendations are enclosed for the committee's review and hopefully study as we, as a coalition, will be marching the halls of Congress over the next two years. We thank you, Mr. Chairman, and we welcome the opportunity to present our views before the committee.

[Ms. Price's prepared statement follows:]

PREPARED STATEMENT OF JOANN H. PRICE, CHAIRMAN OF THE BOARD OF DIRECTORS, SMALL BUSINESS LEGISLATIVE COUNCIL

My name is JoAnn Price and I am the chairman of the Board of Directors of the Small Business Legislative Council (SBLC). SBLC is an independent, permanent coalition of ninety trade and professional associations who share a common concern for the future of small business. Together, our member associations represent the interests of over four million small businesses. The unique characteristic of the SBLC is that we represent nearly every segment of the economy and we do so through the associations. As a result we quickly focus on how a public policy will effect different segments of the small business economy. However, we have never lacked issues upon which we all agree. The common denominator of small business is a strong bond. Our diversity, combined with our common commitment, permits us to offer a unique perspective on the concerns of the small business community.

On behalf of our organization, I wish to congratulate you on your selection as Chairman of this Committee and I would like to pledge our support and cooperation. We anticipate an active 100th Congress and thus expect many challenges.

This hearing is a timely one as we have just completed our 1987 Issues Conference. We were pleased and honored that you, Mr. Chairman, presented the Keynote Address at our Conference. In addition to your remarks, we heard from Chairman Volcker, Dr. Sprinkel, Treasury Assistant Secretary Mentz and Commissioner Nelson of the Immigration & Naturalization Service. At the conference, SBLC members reviewed and discussed more than thirty policy recommendations. At the end of the day we ranked our recommendations in priority order. The final results constitute our agenda for the 100th Congress.

First, I would like to discuss the future of the U.S. Small Business Administration (SBA). At our issues conference we made the following recommendation our seventh priority:

> SMALL BUSINESS ADMINISTRATION. The SBA must maintain its status as an autonomous agency whose sole mission should be to advocate for and assist the small business community, with the private sector's having a stronger partnership role. SBLC recommends (1) strengthening the independent role of the Office of Advocacy; (2) mandating a comprehensive review of all SBA programs conducted under the leadership of the small business constituency; (3) directing SBA to increase its reliance on local resources in the private business sector in the delivery of lending and management assistance services; (4) including the SBA Administrator on all Cabinet Councils affecting commerce, trade, and the economy; (5) expanding SBA's management and technical assistance to small business in regard to government regulations; and (6) requiring SBA to continue matching state SBDC resources and expand the SBDC program to all 50 states as prescribed by the Small Business Act, prohibiting SBA from requiring SBDC's to charge counseling fees, and forbidding SBA from adopting proposed SBDC regulations requiring national program uniformity.

We support a strong, independent agency. We fully appreciate the need for advocates for small business where ever they can be found. We are pleased that the Administration has altered its strategy of "zeroing out" the agency. As you know, SBLC was quite vocal in its defensive of the agency in the last two budget debates. The Small Business Administration fulfills many functions for the small business community, and relative to many other government programs, does so without imposing a significant burden on the American taxpayer.

Over the years we, the small business community, have done much soul searching regarding the agency. Because of our commitment to the reduction of the federal deficit we have voluntarily put many programs on the chopping block. We have a much leaner agency now and, by and large, the general small business constituency is pleased with the results. We must remain vigilant, however, that we do not lose sight of the valuable role the agency can play in providing access to capital for small business, enhancing the job creation process and serving as a focal point for government's commitment to small business. Small business sends a somewhat conflicting message on the role of government--please stay out of my business, but help me with concerns which are beyond my resources. The "less" government relates to the tendency of the government to achieve social, environmental or other such goals by imposing responsibilities on businesses.

The "more government" side of the equation is recognition of the fact the government does have a role in "jump starting" the engine of small business. If one looks at the programs which small business has endorsed, as for example at the White House Conference on Small Business, whether they are tax based incentives or lending programs, these programs are nearly all directed to the early, formative stages of small business when the internal resources of the business are limited. The formula is not complicated. Help small business over the initial hurdles and wait to reap the fruits of our efforts. The dividends of such programs are clearly justified by the ultimate job creation ability of small business.

The SBA helps "jump start" small business. Therefore we must measure the value of imposing more stringent user fees, for example, against the fulfilling the pressing need for capital and the potential for job creation and find the balance.

The proposal to require additional up front fees on guaranteed loans from the borrower and the banks, is a case in point. The acknowledged purpose of the program is to encourage firms which do not have the quick and certain return on investment that appeals to the banking community, but which, as a matter of public policy, we have recognized as having problems gaining access to capital and for having the potential to add new jobs to the economy. It is nothing more than a straightforward public policy choice. Either we spread the risks among all taxpayers or we forego the opportunity. The user fee concept can only be considered within the framework of that public policy decision. If we admit the applicants face such tough odds that we must help them in order to achieve our public policy goals, adding substantial user fees would appear to defeat the purpose of the program. We must be prepared for some failures. The whole idea is we will have more winners than losers. To stack the deck would seem to suggest we want the entire program to fail. I have yet to meet a small business owner who is not willing to pay his/her own way. The issue here is not paying one's own way. It is a fundamental policy choice. Do we believe small business does not have access to capital it needs? Do we believe the overall potential for job creators is worth the risk to the American taxpayer? We believe the answer is yes to these questions and therefore we believe the SBA does provide a valuable service to economy in its lending and investment programs.

The SBIC programs are a second example. The programs have a proven track record of success. These programs are examples of how the public and private sectors can work together as an investment vehicle for creating successful small businesses. These programs should be allowed to grow and it is increasingly apparent to us that the Federal government will not be able to meet the need for investments funds for future expansion of this industry with the current mechanism. Nevertheless some public sector cooperation is necessary as demonstrated by past success. For those reasons, we continue to support passage of legislation to create the Corporation for Small Business Investment (COSBI). As you know, COSBI nearly passed in the 99th Congress. We hope it will move on a fast track this year. We believe it is the prototype of the future.

A third example of our concern is the future of the Small Business Development Center (SBDC) programs. As we view them, the centers have matured to become extremely effective and efficient "spark plugs" for small business. They, too, represent a classic example of leveraging resources to their fullest. The states and universities have demonstrated their commitment to the program. Now that they have been convinced of the value of the program, we cannot accept that as an automatic justification for the Federal government to abandon the programs. A smart state recognizes the value of a diverse economy and should invest in the future of small business, but that does not make a federal commitment to the overall economy any less necessary. Tinkering with the formula for success can only lead to a waste of this valuable program.

Although the focus of this hearing is on the SBA, it is the first set of hearings of the 100th Congress and we believe it is necessary to place our priorities on the table. It is not our intention to devote our entire agenda to the Small Business Administration. We hope that it is a battle we do not have to fight this time around. We hope the details can be worked out to preserve programs such as the Small Business Development Center program and SBICs which are proven winners. We are optimistic such will be the case.

Frankly, there are too many other issues on the small business agenda, some of which need our immediate attention. In this regard we hope this Committee will aggressively pursue the small business agenda beyond the four walls of the committee room. Small business needs advocates where ever we can find them. Many of the issues before us are not within the legislative jurisdiction of this Committee, but we do need someone to represent us effectively before committees in which our issues do fall such as Ways & Means and Government Operations. We hope you will work on our behalf; you can be sure you will have our support.

I would like to discuss briefly the results of our issues conference. We have thirty recommendations to offer to you today. They are the culmination of three months of SBLC committee meetings and the final deliberations at our annual meeting. They cover diverse subjects from antitrust to international trade policy. They are remarkably consistent with the results of the White House Conference on Small Business and the agendas of our colleagues within the small business community such as NFIB, NSBU and the Chamber's Small Business Council. In that regard, I believe you will find small business united in its efforts.

I will not discuss all of our issues in detail but I would like to highlight a few recommendations. The top priority of SBLC in 1987 will be opposition to government mandated benefits. These benefits cover a spectrum of initiatives from parental leave to health insurance. Small business objects to such mandated benefits not only on the basis of the cost but also because they inhibit management flexibility. In a small business, such flexibility can made the difference between success and failure. The emergence of the concept of mandated benefits is disturbing. We believe it is indicative of a trend to push more of the responsibility for social goals upon the shoulders of small business. We believe small business is already responsive to the needs of its employees. Small businesses are certainly more dependent on each employee for the overall successful and smooth operation of the business. We also believe small business assumes its share of responsibility to the community and society. Therefore we must ask the question: At what point will we reach the breaking point for small business? In addition to the mandated benefits, there are new discussions on increasing minimum wage, passing stringent employee notification laws and banning the use of polygraphs to name just a few of the items already placed on the table in the 100th Congress. Each of these legislative initiatives exacts a price; in the aggregate the price may be more than the small business community can bear.

Our second recommendation represents our views on tax policy for small business. We were not fans of the Tax Reform Act of 1986. In this recommendation we have attempted to establish what we view to be an appropriate taxation and capital formation policy which will promote the growth of small business.

Our third recommendation cites the need for comprehensive tort reform and the passage of uniform product liability legislation. While the tort reform/insurance regulation crisis may be ebbing, the systemic flaws remain and we must address them.

Our fourth priority is the enactment of further spending reductions and tough laws to create a balanced budget/deficit reduction process that works. Also included in the recommendation is a statement in opposition to any tax increase, regardless of how "euphemistic" the nomenclature.

Our fifth recommendation calls for reforms of insurance industry regulation. Small business recognizes that all sides were to blame for the recent crisis. If we are to have affordable, available insurance in the future we must do more than revise the civil justice system, we must provide for a sophisticated regulatory scheme equal to task of managing a global industry. In the 99th Congress, you were among the leaders on this issues and we hope you will continue your fight on behalf of small business.

I would like to mention just a few other recommendations of our issues conference. International trade policy was a significant concern. Mr. Chairman, you have long been an active supporter of restoring our industrial sector to a competitive level in the world marketplace. The problem has reached critical mass. At a minimum we need to help small business gain access to export markets and we wish to work with you to shape a small business title for the trade bill. We must also look to see how our growing professional and technical services sector can respond to our international trade problem.

Competition by non-profits, governments and regulated monopolies with small business is a growing problem and admittedly a controversial one. We hope this committee will help us find solutions and work with the Government Operations Committee and the Ways & Means Committee to explore alternatives.

We have several recommendations regarding the professional and technical services industries. National public policy is simply not responsive to the needs of this growing economic section and frankly, the federal government is behind the curve whether it be revision of SIC codes or procurement policy for purchasing such services.

Looking to the future, we are not as confident about the status of small business in the economy of the year 2000. It will be more than a year before we feel the first effects of the Tax Reform Act of 1986 and it will certainly be many years before we feel the full impact. In our organization there was considerable opposition to the bill as it made its way through Congress. One specific concern, expressed at the time, was the disproportionate negative impact of the bill on small corporations. These are the firms which constitute the innovative, job creation sector of the economy and these are the firms which must go head to head with the mega firms. The Tax Reform Act of 1986 challenges some the fundamental principles of how tax policy allows these firms to compete and expand.

We are particularly fearful of the impact of tax policy in light of the restructuring of economic power which has taken place through mergers and acquisitions. The small business sector has not yet felt the squeeze resulting from the merger and takeover activity of the last few years. It is our view the impact cannot be measured accurately with the economic analysis currently in fashion. We hope this Committee will look at the long term picture for small business. Combined, the twin towers of tax policy and antitrust policy represent powerful forces which will alter seriously the economic landscape in the 1990's and in the twenty-first century if we do not act now.

Small business must be the center piece of our economic policies not the show piece. National policy must be shaped around our understanding of small business. Small business should not have to cope with public policy, they should prosper under public policy. Our goal is to shape a framework that recognizes that our future, as has our past, must be invested in small business.

Our full list of recommendations follows. As you can see, the agenda is a full one, but a manageable one. We believe it is realistic but also looks to what lies ahead for small business in the year 2000. We would like to thank the Committee for your time and attention. We look forward to working with you in the 100th Congress.

Priority Number 1

MANDATED BENEFITS. There should be no government mandated employee benefits. Rather, Congress and the states should explore creative alternatives for the private sector, including tax favorable incentives for encouraging the provision/expansion of employer-sponsored health care and other employee benefits.

The Small Business Legislative Council supports the following actions:

1. Rejection of any type of mandated benefits.

2. Equalization of self-insured and fully insured health plans with respect to existing mandated benefits.

3. Exploration of alternatives that retain a voluntary flexible benefits system and at the same time enable employees to fulfill their job and family responsibilities.

Small businesses are less likely than large businesses to provide employees with health and other fringe benefits, primarily because of relatively higher funding and administrative costs. Mandated benefits impose additional costs and are likely to widen further the gap between large and small businesses.

For almost a decade the states have been imposing hundreds of requirements on commercial health plans. The laws vary from state to state, but generally pertain to three areas: inclusion of specific services, such as mental health care; coverage of certain providers, such as chiropractors; and coverage of certain individuals, e.g., widows, who may purchase health insurance at group rates through the employer.

Under the Employee Retirement and Income Security Act of 1974 (ERISA), the Federal government is responsible for regulating self-insured plans. This distinction is important because while most small employers use traditional health insurance and therefore must pay for mandated benefits, the majority of large employers are self-insured and not subject to these state requirements.

Recently the Federal government has turned to the employer and has imposed mandates similar to those passed by the states. The first Federally mandated health benefit was included in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). Employers with twenty or more employees with an employer-sponsored health plan are required to offer coverage to divorced spouses, widows, certain dependents, and employees terminated for any reason short of gross misconduct.

Other proposals introduced include: continuation of the employer's contribution for laid-off employees for four months; mandated family and medical leave, including continued health insurance during a worker's absence; and the establishment of state risk pools, with the pool's losses financed by an employer tax. Proposed legislation would typically disallow an employer's present health care tax deduction unless a particular benefit was provided, or specified group covered.

Priority Number 2

COMPREHENSIVE TAX FORMULA FOR SMALL BUSINESS GROWTH. The small business community will often be particularly hard hit by specific provisions of the Tax Reform Act of 1986. Small corporations will receive smaller reductions in corporate rates than large corporations under the 1986 Tax Reform Act. They will be adversely affected by the elimination of the investment tax credit, capital gains, and extension of depreciable life of capital assets. SBLC continues to strongly recommend enactment of the following proposals which are necessary if small business is to operate effectively.

1. Payroll Taxation. SBLC supports changes in payroll tax deposit rules to ease the burden of payroll taxes on small firms while in no way reducing the responsibility of the business owner, including amending IRS regulations by increasing the threshold for making payroll tax deposits from current levels; consider employers with gross annual deposits of less than $75,000 to have complied if the deposit is not less than 90 percent of the taxes for the period; and other provisions.

2. Accounting. SBLC also supports simplified accounting and inventory valuation rules that will foster capital formation and retention, including (A) increasing to $10 million in annual sales the limitation for firms which can use simplified LIFO pooling rules; (B) permitting any small business to use a single inventory pool and a single price index for determining the LIFO deferral; (C) allowing any small business, including manufacturers, to elect the cash method of accounting if gross sales are less than $10 million; and other provisions.

SMALL BUSINESS GENERAL TAX RATES

Small business is often labor and inventory intensive. Thus payroll, income, and other taxes are at extremely high effective rates--far in excess of the average for all businesses. SBLC supports the following tax changes:

1. Rate Progressivity. The Tax Reform Act of 1986 imposes a new general rate structure which greatly lessens the progressivity of the previous system. As a result, its provisions often fall most heavily upon small business. This is especially true of the "recapture" provisions which impose an artificially high rate on earned income between $100,000 and $335, 000. SBLC urges enactment of a directly progressive rate scale which would eliminate recapture provisions entirely, or alternatively, a rate scale which would shift the burden of revenue "recapture" to wealthier, higher income taxpayers.

2. Taxation of Fringe Benefits. Members of Congress and the Administration have discussed tax changes which place limits on the amount of fringe benefits received by employers and employees, including use of motor vehicles, medical expense premiums in excess of a cap and all other premiums paid by an employer. The taxation of premiums for these coverages is certain to result in cancellations of many plans and reduction of benefits, many of which are not generally available to individuals. SBLC opposes taxing individual employees or employers for the imputed cost of group life and medical insurance, and for other essential fringe benefit programs.

3. Social Security. The Social Security system must be put on a sound financial footing. SBLC opposes (A) the use of general revenues for funding the Social Security system, and (B) any additional increase in social security tax rates applied only to employers.

CAPITAL INVESTMENT FORMATION AND EXPANSION

In recent years small business has become the "engine" which as sustained this nation's economic growth and expansion. The small business community currently accounts for more than forty percent of the gross national product and is responsible for more than two thirds of all new jobs which have been created. Yet its ability to maintain and expand this crucial role is vitally dependent upon adequate supplies of investment capital. Competition for such funds is often unfairly structured against small business. Our national economic welfare demands that government tax and investment policies actively promote greater levels of small business investment and expansion. Specifically, SBLC endorses immediate legislative enactment and administrative implementation of some reasonable "mix" of the following proposals:

1. Capital Gains Taxation.

(A) A federal capital gains tax provision restoring a meaningful differential must be enacted to assure adequate availability of equity capital for new and growing small businesses. A low capital gains rate with a significant differential is also needed to attract senior management talent for young, growing companies. The failure of the recently enacted Tax Reform Act to not retain a permanent long-term capital gains differential will make it extremely difficult for independent companies to obtain much needed growth capital and award risk taking managers as it highly favors listed, dividend bearing securities of larger businesses.

(B) There should be enacted a provision permitting the deferral of a capital gains tax liability provided the proceeds from the sale of a capital asset are reinvested in a qualified small business concern. A "rollover" provision would serve as an incentive to invest in long term, illiquid and higher risk, but nevertheless innovative, job producing companies that now find it very difficult to tap the equity markets. The proposal is analogous to the tax treatment afforded homeowners on the sale of a residence. SBLC supports the concept of a capital gains tax deferral on reinvestments in small business and urges Congress to pass legislation amending the Tax Code to create this incentive for investment in small firms.

2. Tax Credits and Expensing of Assets.

(A) The SBLC strongly endorses enactment of a program of Capital Cost Recovery Credits. Such a program would provide appropriate tax credits for investments in new and used machinery and equipment. It would, however, be targeted on a limited, graduated basis to all forms of small business, including retailing and wholesaling.

(B) Direct tax write-off for investments in small business by individuals. This tax change would permit individual investors to take a deduction of up to $15,000 on their tax returns ($30,000 on joint return) for a direct cash investment in qualified stock of a small business concern. The small business could sell up to $250,000 worth of stock having this tax benefit. SBLC proposes a series of qualifications and safeguards to ensure use by the intended range of small firms and to prevent abuse, and urges Congress to amend the IRS Code to create this new incentive for investment in small business.

(C) Direct and immediate expensing is of critical concern to small business. Proposals which will achieve this goal include more rapid accelerated depreciation, increasing the levels of the current immediate expensing provisions for small business or ultimately enacting a comprehensive direct expensing system for all capital assets.

3. Government Support Programs. Governmental efforts at a variety of levels can provide positive assistance to small businesses in their efforts to raise adequate capital for expansion and growth. Among the various suggestions which SBLC would endorse are the following:

(A) Corporation for Small Business Investment (COSBI). COSBI would be a privately-owned and managed, federally chartered corporation which would act as a "capital bank" for the minority and small business investment company industries. This new financial intermediary between the private capital markets and the SBIC industry would replace government funding of the SBIC program with funds from the private sector. In addition, SBA's involvement in the SBIC and MESBIC programs would be terminated and replaced by a more efficient and more business-like self-regulatory system managed by the new corporation. SBLC urges Congress to pass the enabling legislation to create COSBI as soon as possible.

(B) Small Business Participating Debenture (SBPD). The Small Business Participating Debenture is a new form of hybrid security designed to generate significant amounts of capital investment in small business on terms attractive to both the small firms and investors. It would combine certain debt characteristics (such as an interest rate and maturity date) with equity-type characteristics (such as a share in the net profits of the issuing enterprise). The major benefits of the SBPD concept to the small business and investors are tax consequences. SBLC supports the concept of SBPDs and urges passage of legislation by Congress as quickly as possible to amend the IRS Code to create SBPDs.

(C) Loan Guarantee Corporations. Federal or state legislative bodies shall encourage, authorize and approve the creative use of semi-public loan or guarantee corporations to meet the needs of small firms. This capital can be used for start-up, venture capital, business expansion, capital improvement, fixed asset financing, and/or intangible collateral financing. These vehicles shall be many, or multi-faceted and self funded revenue neutral items. It should create a loan guarantee vehicle similar to Fannie Mae (FNMA) to meet the needs of small business.

(D) Small Business Reinvestment Corporations (SBREC). Authorize the formation of small business reinvestment corporations to obtain capital from private and public pension plans and invest that capital in small business. Federal enabling legislation will provide that such investments comply with the prudent man rule for pension plan trustees.

4. Equitable Access. Surveys conducted by the American Management Association and National Association of Women Business Owners indicate that women business owners encounter discrimination in acquiring financing. While regulations issued by the Federal Reserve Board (FRB) to implement the Equal Credit Opportunity Act of 1972 should have eradicated barriers based upon sex (and other factors). FRB's rules generally exempt business credit transactions from the rules requiring notification, retention or records and inquiries about marital status. This exemption hampers the ability of enforcement agencies and women entrepreneurs to detect illegal discrimination, eliminates incentives for financial institutions to monitor their own practices, and makes it impossible for public policy makers to know whether they need to address discriminatory practices or other types of barriers to full access to credit. SBLC supports initiatives to ensure access of women-owned businesses to credit, including withdrawal of the current exemption of business credit transactions from provisions of the Equal Credit Opportunity Act.

Priority Number 3

TORT REFORM/PRODUCT LIABILITY. The Federal government should foster a civil justice system that will: retain fault as the basis for liability; base causation findings on credible scientific and medical evidence and opinions; eliminate joint and several liability; limit non-economic damages to a fair and reasonable amount; provide for periodic payments of future economic damages; and, reduce awards by collateral sources of compensation for the same injury. Further, the critical problem of product liability can only be resolved by passage of national uniform product liability legislation.

The issue of tort reform is a complex one and several factors contribute to the problem. We have become a litigious society and the rules of the game have changed over the years. Legal theories, upon which our system is based, have been slowly and subtly altered and now the cumulative impact is a system out of balance.

The problem extends to all types of business liability whether product, professional or general liability. The nature of the problem appears to be two fold regardless of the type of liability. First, we have obscured the concepts of negligence and accountability to the point that small business can no longer undertake an activity with confidence, no matter how responsible that action may be. And second, there appears to be only a limited link between the finding of fault and the awarding of damages.

Small business owners shudder at the thought of federal regulation. It is not a concept which sits well with them. Further, the two major contributors to the problem--the tort system and insurance regulation--have been tradition areas for State activity. As such, much of the reform could take place at the State level, but we stress the could.

This is now a national problem, and demands national attention. Can effective reform be achieved through Federal legislation? Possibly it can. The civil justice system was created primarily at the State level and its problems should be solved there. If we are to obtain relief in our lifetime however, we must have Federal action. Even with Federal legislation, State action will be needed to supplement the actions of the Federal government.

Product liability is a unique aspect of the tort reform crisis confronting this country. Each State applies widely varying standards to products in interstate commerce, and the current administration of civil justice as it relates to product liability creates chaos and ultimately results in higher costs to the consumer and businesses, without providing effective protection for the product user. Adoption of a uniform national standard for product liability must be a national priority.

Priority Number 4

DEFICIT REDUCTION AND FISCAL POLICY. Since 1981 the national debt has doubled, reaching a total amount in excess of $2 trillion. A debt of this size, and the magnitude of the continuing annual deficits which have created it, pose major threats to the economic health and security of the United States. They threaten to place substantial control of the United States economy into the hands of unsympathetic foreign investors. They divert substantial government capital into non-productive interest payments, now the fastest growing "program" in the federal budget. They cause massive competition between the government and the private sector for loanable funds, thus drying up important capital resources. This is especially damaging to small businesses already seriously handicapped in their struggle with larger, wealthier competitors for vital bank loans. Finally, in the absence of immediate crises, they place unacceptable risks and burdens upon future generations, virtually mortgaging their chances for prosperity. In summary, the federal government must act immediately and responsibly to control and ultimately reduce the national debt and the annual deficits which produce it.

Effective control over these burdensome federal budgetary deficits depends primarily upon constructive approaches to reductions in government spending. Unfortunately, the size and scope of countless government programs have reached levels which are totally unacceptable. For example, in the past five years the actual size of our federal bureaucracy, spending, and resulting deficit has continued its alarming upwards spiral. Total government employment has not come down but has increased from 4,966,000 in fiscal 1981 to 5,210,000 in fiscal 1986. Federal expenditures likewise have increased from $590.9 billion to $979.9 billion. The federal debt doubled by 1985 and has now crossed the $2 trillion mark. Net interest on the debt has almost tripled, the trade deficit is now four times larger, and for the first time since 1959 the United States is now a net importer of food. This trend must be reversed.

The Gramm-Rudman-Hollings Act has provided us with a reasonable legislative timetable for final elimination of our annual deficits. Any efforts to weaken its schedule or "stretch out" its deadlines must be resisted. Prompt and timely action is a necessity.

It would be preferable if the Congress could carefully review each individual program and exercise thorough oversight judgment to reach reduced spending targets. However, if the pressures of politics and timing prevent such careful crafted review, then mandatory spending reductions should be imposed. The automatic "sequestration orders" issued by the Comptroller General's office in the original Gramm-Rudman-Hollings Act point out the proper direction. While this procedure was recently struck down by the Supreme Court in Bowsher v. Synar on a Constitutional technicality, innovative legal approaches are available to remedy these deficiencies without sacrificing the basic, automatic nature of the spending reduction process. (See, for example, the "Gramm-Rudman-Hollings II, Perfecting Amendments" offered in the 99th Congress, 2nd Session (1986), 132 CONG. REC. S9840). Strong support should be given to legislation which restores automatic across-the-board reductions in federal spending in the face of Congressional inability or unwillingness to reach the legally required deficit levels set out in the Gram-Rudman-Hollings Act.

In recent years the deficit issue has given growing prominence to a variety of taxation increase proposals such as a National Retail Sales Tax (RST), a Value Added Tax (VAT), a Business Transfer Tax (BTT), a Personal Expenditures Tax (PET), and a variety of Oil Import Fees (OIF). The SBLC believes that these plans would do serious damage to the national economy, the small business community, and numerous individual citizens without providing significant or meaningful solutions to the deficit crisis. We have strongly argued against their passage, and the Congress of the United States has agreed.

Any comprehensive and objective analysis of the proposals for tax increases discloses sound reasons for incurring strong small business opposition. In addition to general objections to unnecessary tax increases, including Congress' failure to first control federal spending, the proposals are unsound and insupportable, for these reasons:

A. Revenue enhancement cannot be allowed to serve as a direct or indirect excuse for federal spending increases. Proposed forms of added taxation have not provided specific legal guarantees that all revenues raised would be applied directly and exclusively to deficit reduction. This has been a major challenge to the legal structure surrounding all such proposals.

B. Proposed forms of higher tax burden will not significantly contribute to deficit control and are likely to be far more disadvantageous to business and administratively costly than its minor benefits. Proposed tax increases have failed to guarantee reductions in budget deficits.

C. Proposals to increase taxation have fallen more heavily upon the nation's small businesses and have been unjust and unproductive and have not applied fairly and progressively to the individuals and/or businesses affected.

D. Complex and costly administration has been particularly burdensome to the millions of small businesses throughout the nation. The administrative and reporting requirements involved in taxation proposals are complex and expensive.

E. Any slowing of economic growth will only produce substantial hardships as well as counterproductive shortfalls from other revenue sources and increases in federal assistance spending. New tax proposals have failed to avoid any major negative impacts upon national economic growth as they adversely affect employment, investment, consumption, or planning.

F. The dangerous precedents involved must be fully considered. While initial suggestions often involve specific exemptions in categories of taxpayers or goods, certainty that over time there would not be a dangerous erosion of such provisions has not been assured.

In summary, Congress must recognize that as a solution to the national debt crisis, new forms of taxation or rate increases pose the most serious dangers to the economic health and welfare of our national economy, the entire small business community, and the vast majority of our individual citizens.

Priority Number 5

CASUALTY INSURANCE. The ability to obtain casualty insurance at reasonable, affordable prices continues to be a problem faced by small businesses and individuals throughout the nation. The current crisis is a recurrent characteristic of the insurance industry manifested about every eight to ten years. The present crisis may linger longer in the crisis phase than has been true in past cycles.

The costs surges and non-availability of certain lines of insurance follow periods of highly competitive, possibility predatory behavior of the insurers in seeking premium dollars for investments, especially during periods of high returns on capital. These cyclic periods of below-cost sales of insurance products (termed cash flow underwriting) appear to be repetitive, irrational behavior.

Regardless of where blame may properly rest, this current crisis has resulted in severe losses to certain elements of the insurance industry in addition to thousands of insureds, particularly small businesses, depending upon this product, have experienced price shock and unavailability of insurance. The cyclic behavior, the absence of any national oversight, and the dearth of data suggest the need for federal examination and study of the insurance industry.

Effective state regulation of these national and international corporations cannot be accomplished without improved centralized data-gathering from which state regulators and legislatures can obtain meaningful information needed to regulate the insurers.

Both federal and state antitrust principals must be applied to the extent possible in judging the behavior of the insurance industry. The scope of the McCarran-Ferguson antitrust exemption for the insurance industry must be carefully reexamined. Small business recognizes, however, the need, particularly for small insurers, to have available adequate data to compete. The Federal Trade Commission should again be authorized to study and investigate the activities of this essential industry.

The main concern of small business is the ensure the continuous availability of competitively priced insurance through the stability and solvency in the insurance industry. A federal centralizes data activity which can assist the states to effectively regulate the business of insurance or state promulgated regulations, prohibiting insurers from directing insureds to specific providers of goods and services except upon written requests of insured, are examples of actions which will achieve such goals.

Priority Number 6

INTERNATIONAL TRADE POLICY. The participation of small businesses in the international market represents an important and fundamental criterion for the resurgence of the United States trade position. The following areas must be addressed and policies adopted in order to ensure "fair" trade for U.S. firms in the world market:

a. Financial and management assistance to enable more small businesses to compete in the international market.

b. Removal of barriers to international trade, such as licensing, specification and nationality requirements not otherwise imposed on domestic firms.

c. Measures to encourage small firms to export, such as stronger patent and proprietary data protection as well as programs to assist firms to convert to the metric system.

d. Stricter and more thorough enforcement or improvement of current United States fair trade laws.

e. Adoption of a clear and forceful international trade policy, either through creation of a cabinet level position or enhanced coordination and focus of current policy-makers.

f. A right of private action with compensation to the injured party should be created to enable access to remedies by small business. A "short form" expedited, low cost proceedings before the ITC should be established.

g. The Standard Industrial Classification (SIC) code should be massively overhauled so that it will evolve with the continuing diversification and growth of the American economy, and provide timely information to policymakers and business users. In addition, a Commission on Services, Information, and High Technology should be created by Congress to recommend statistical, trade, tax, procurement and other policies which will enhance America's competitiveness, both internationally and domestically.

Priority Number 6

FAIR COMPETITION. In order to protect small businesses, and consumers, from damaging levels of unfair competition, federal, state and local laws, regulations and policies should:

a. Prohibit unfair competition in which non-profit tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses.

b. Prohibit direct, government-created competition in which government organizations perform commercial services.

c. Prohibit government sanctioned monopolies, such as utilities, from using their monopoly resources to compete in other markets.

These goals should be achieved in, but not limited to, the following ways:

Non-profits: Tax-exempt entities should not be permitted to use their tax status or postal rates to compete with commercial providers of products and services. Non-profit organizations receiving government grants and contracts, including Federally Funded Research and Development Centers, should be prohibited from using federal dollars to compete with products and services provided by the private sector. Non-profits engaging in commercial activities should be prohibited from doing so while enjoying exemption from government regulations such as antitrust laws, worker's compensation, and health and safety rules.

Governments: New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a government operated commercial activity on U.S. property. Further, public funds extended by federal, state, and local government must be utilized, to the extent feasible, to contract for goods and services from the private sector.

Utilities: Government regulated utilities should be prohibited from using their government favored position to compete in markets already served by small businesses.

Priority Number 7

SMALL BUSINESS ADMINISTRATION. The SBA must maintain its status as an autonomous agency whose sole mission should be to advocate for and assist the small business community, with the private sector's having a stronger partnership role. SBLC recommends (1) strengthening the independent role of the Office of Advocacy; (2) mandating a comprehensive review of all SBA programs conducted under the leadership of the small business constituency; (3) directing SBA to increase its reliance on local resources in the private business sector in the delivery of lending and management assistance services; (4) including the SBA Administrator on all Cabinet Councils affecting commerce, trade, and the economy; (5) expanding SBA's management and technical assistance to small business in regard to government regulations; and (6) requiring SBA to continue matching state SBDC resources and expand the SBDC program to all 50 states as prescribed by the Small

Business Act, prohibiting SBA from requiring SBDC's to charge counseling fees, and forbidding SBA from adopting proposed SBDC regulations requiring national program uniformity.

Priority Number 8

ANTITRUST, MERGER AND PREDATORY ACTIVITY. The SBLC reaffirms its belief that the foundation of American antitrust policy must be a commitment to decentralized and deconcentrated economic and political power. Consistent with such a commitment is the creation of economic conditions in which both consumers and private enterprise enjoy optimal choice and opportunity created through active and fair competition. Therefore, ongoing enforcement of the broad mandates of existing antitrust laws should produce a diversified economy characterized by an abundance of small businesses, producing employment, innovation, and economic freedom. Congress must undertake long-range enforcement planning and monitoring which will deter economic concentration and anticompetitive marketplace activities. Specific SBLC recommendations include: (1) preservation of antitrust enforcement efforts through provision of appropriate authority and resources to agencies such as the Federal Trade Commission and the Department of Justice; (2) careful personnel review to insure that relevant policymaking officials demonstrate a genuine commitment to a meaningfully competitive marketplace featuring a healthy and expanding small business component; (3) diligent oversight of existing specific enforcement policies through utilization of recently passed legal reporting requirements as well as legislative hearings where appropriate; and (4) resistance to any statutory revisions which would weaken current laws, such the proposed "The Antitrust Remedies Improvement Act" which would seriously reduce the available damage remedies now serving as a strong deterrent to potential predators.

Merger Policy

The Department of Justice and the FTC have escalated a trend of permission for giant corporate mergers while simultaneously engaging in strong enforcement measure against relatively small mergers and acquisitions. Worse still, has been the introduction of statutory revisions, such as the Administration-supported "Merger Modernization Act." which would significantly weaken present Clayton Act restrictions upon proposed mergers. SBLC urges that the FTC carefully scrutinize mergers and acquisitions, particularly those involving larger corporations, and grant approval only when clear and convincing evidence supports the economic and social viability of such action. SBLC also urges that Congress decisively reject any legislative attempts to substitute standards of market power and economic efficiency for the broader, more desirable, condemnations of monopolies and anticompetitive practices contained in present statutes.

The Robinson-Patman Act

The Robinson-Patman Act forbids price discrimination between purchasers of goods of like quality in interstate commerce. A jurisdictional requirement of the Act allows action under the Act only where the price discrimination may lessen competition or tend to create a monopoly. Large buyers may claim a purchasing advantage, but this must be based on the cost-justified volume of their purchases. SBLC recommends that the "administrative repeal" of the Robinson-Patman Act must be reversed, funds specifically for Robinson-Patman Act enforcement need to be appropriated, and the Federal Trade Commission must be required to show the effects of its enforcement. Enforcement of laws to prevent predatory pricing must be reinforced, if necessary, by Congressional action, and vigorously enforced by the FTC.

Foreign Competition

It is possible that major trade reform legislation in areas such as "dumping" and economic subsidies can be created to assist the small business community. However, the rising emphasis upon "competitiveness" should be permitted to justify fundamental revisions of domestic antitrust statutes. SBLC believes that conclusive proof of beneficial foreign trade results in an essential prerequisite of any legislative alteration performed for this reason. Permission for more anticompetitive mergers at home will not fundamentally alter any relevant competitive conditions abroad. It will only seriously reduce the vitality of domestic competition, small business profitability, and consumer choice.

Priority Number 8

SMALL BUSINESS PARTICIPATION IN PROCUREMENT. A fair proportion of the purchases and contracts for goods and services required by the federal government should be awarded to small business concerns. The federal government's goal should be to contract with qualified small businesses in order to broaden the number, diversity, competitiveness and availability of competent and experienced contractors to support the public's needs. Small business participation should be a significant percent of the contract dollars for each industry; and eventually, it should reflect the level of small business contributions to the Gross National Product.

These goals can be achieved through the following actions:

a. Distribute procurements, made through set-asides by federal agencies, across all categories of goods and services for small businesses. Distribution should be proportionate to small business share in each SIC Code based on the needs of the industry represented by the SIC Code.

b. The federal government should develop a standard approach for setting size standards by SIC Codes based on sound economic data to ensure the size standards are equitable, rational, and consistent. Further, the government should develop procurement procedures that ease "graduation shock" for companies transitioning out of their small business size standards.

c. Require that all agencies annually publish a 2-year procurement plan that identifies known potential procurements for small businesses and designates those to be set aside where appropriate.

d. Require that all agencies annually publish a 2-year report on the number, size, and total contract dollars awarded to small businesses in each industry category.

e. The federal government should assist small business concerns, especially those owned by minorities and women, to effectively compete for federal contracting opportunities as contractors or subcontractors by eliminating barriers such as prevailing wage laws (Davis-Bacon Act, Service Contract Act) and establishing incentives to foster expanded participation.

f. Recognize that notwithstanding the fact that the "Rule of Two" can be an adequate standard for determining small business set asides in many industry categories, it does adversely impact certain industries; and as such, it should reflect the changes legislated by section 921 of the FY '87 Defense Authorization bill which establishes size standards and set-aside targets for those affected industries. Similarly, in other industries where small business has not received an equitable share of contract dollars, the rule of two must be enforced vigorously.

g. Federal agencies should be encouraged to purchase products and services from local dealers as part of the Multiple Awards Program run by the General Services Administration. GSA should seek the inclusion of local dealers in multiple awards contracts to ensure that U.S. agencies receive adequate sales and technical advice, service and support.

Priority Number 9

DOUBLE-BREASTING LEGISLATION. Congress should not restrict competitiveness in the construction industry by limiting the freedom of investment and ownership. Congress should defeat proposed anti-double breasting legislation.

Legislation under consideration by Congress would redefine single employers and compel management to apply pre-hire agreements to workers. The legislation would prohibit common ownership of two or more enterprises with different labor relations even though the companies are kept completely separate.

1. It restricts free enterprise by preventing the contractor from operating both a union and non-union operation.

2. It weakens our current labor laws by limiting the decision of individual workers and the assurances workers have to control their own destinies through the collective bargaining process.

3. It limits the potential markets of both union and non-union contractors. By doing so, it limits job security for both a union worker and a non-union worker.

4. It broadens the existing pre-hire exemption now found in the National Labor Relations Act.

5. Provisions limiting common control could permit common situs picketing on jobs under common control of a prime contractor. The restrictive nature of the legislation will force contractors and

construction jobs to be completely union or completely non-union regardless of the competitive role in the marketplace or the preferences of workers.

6. It forces pre-hire agreements onto employees and would subject them to union contracts which they have not agreed to.

Priority Number 10

THE VOLUNTEER PROTECTION ACT. The current crisis of liability insurance has hit our organizations hard in many areas. One area that has been particularly vulnerable for non-profit organizations has been protection for volunteers that give their time and talents serving on boards, committees, and task forces for our organizations. As premiums for this type of liability coverage climb upwards of $5000 to $10,000, many organizations are forced to "go bare." Under these circumstances, many quality volunteers refuse to give of their time and look for less vulnerable opportunities.

One effort to remedy this situation was the introduction of The Volunteer Protection Act into 99th Session of Congress by John Porter (R-IL). The bill encourages states to extend civil liability immunity to volunteers working on behalf of non-profit organizations and only hold volunteers responsible for "willful and wanton misconduct."

The Small Business Legislative Council expresses its support for The Volunteer Protection Act, as proposed by Congressman John Porter, and urges Congress to adopt the Act at its earliest opportunity.

Further, SBLC recognizes the need for state legislatures to consider and enact this bill to provide national protection and, thus, encourages those states that have not enacted volunteer civil immunity laws to do so at the earliest opportunity.

Priority Number 11

STRENGTHENING THE PROMPT PAYMENT ACT. The Prompt Payment Act of 1982 should be strengthened through an amendment which will:

-Eliminate the 15 day grace period;

-Require automatic payment of interest penalties;

-Define clearly that the entire payment process, including acceptance, must occur within 30 days.

-Require that interest penalties be paid on late progress payments and retainage;

-Require that contractors pay their subcontractors and suppliers at any tier within seven days after receiving their payment;

-Prohibit the taking of early discounts unless the agency has complied with the payment terms;

-Mandate that prime contractors pass through to their subcontractors any late interest penalties received from the government;

-Extend the protection of the act to contractors under federally assisted programs, U.S. Postal Service Contractors, and Contractors providing goods or services to Medicare and other federal programs utilizing fiscal intermediaries;

-Require the annual reports on the implementation of the Act to provide more detailed information.

The Prompt Payment Act, as amended, must be enforced vigorously by all branches of government.

Priority Number 11

INCREASED SMALL BUSINESS COMPETITIVENESS THROUGH IMPROVEMENTS IN THE PROCUREMENT OF PROFESSIONAL SERVICES. Professional and technical services constitute a dynamic and fast emerging sector of the United States economy. The procurement of these services by the federal government has grown significantly in the past few years without a parallel expansion in the current acquisition system. The following steps should be taken to meet the emerging needs:

a. The acquisition system needs to be redesigned to more efficiently acquire services, as opposed to goods and materials.

b. Technical training of federal program and contracting personnel concerning the acquisition of professional and technical services is needed.

c. Improved methodologies must be developed that emphasize quality in the procurement of complex and sophisticated services. If such services are acquired predominantly on the basis of lowest price without proper regard for quality, the government will in fact end up, in the long run, paying more, not less, for needed services. Additionally, this improved methodology which emphasizes quality will encourage greater innovation and productivity in private sector work for the federal government.

d. Develop and implement on a demonstration basis a simplified alternative acquisition process that assures the federal government the benefits of competitively procured services and increased access to the market for businesses of all sizes, including small business firms.

e. The federal government should utilize the 40 hour work week as the basis for competition for contract awards, to assure that the right balance is maintained between quality and cost/price factors.

f. The federal policy for profits should differentiate between manufacturing, research and development, and services to ensure adequate profits to encourage the private sector to compete for federal procurement opportunities.

g. The Standard Industrial Classification (SIC) code should be massively overhauled, so that it can evolve with the continuing diversification and growth of the American economy and so that it can provide realtime information to policymakers and business users. An appropriate methodology would allow for crosswalking between all major federal data systems; identify the amount of commercial economic activity performed in the not-for-profit, franchise and similar sectors; and be dynamically updated.

Priority Number 12

FINANCIAL SERVICES. The SBLC supports the legislative efforts to close the nonbank bank loophole and to promote the continued separation of banking and commerce.

By exploiting an unintended loophole in Federal law (the so-called nonbank bank loophole), commercial firms, including national retailers, are buying banks and S&Ls. Over time, this will threaten the impartial allocation of credit, promote enormous concentrations of finance and commerce and undermine the competitive position of various small business entities, including small banks. In his formal testimony before the Senate Banking Committee on January 21, 1987, Chairman Volcker outlined the stakes for small business. He stated: "Suppose we have our banking run by various commercial firms over the country with offices in retail chains and so forth. Will these banking offices serve the general needs of other borrowers in the local community. Suppose the local appliance dealer comes in there and asks for loans from a bank run by a large retail chain. I suspect that branch manager isn't going to be happy to provide the money to the local retail establishment. If he does, I suspect he is going to find himself selling shoes instead of running the bank offices before very long."

Volcker's statement underscores the threat of the loophole to the impartial allocation of credit. The small business community must also be concerned about the future supply of credit, since the nonbank bank loophole would allow any firm with nationwide offices to establish nationwide deposit-taking networks run from New York or Tokyo.

The exploitation of this loophole in the Bank Holding Company Act is a relatively recent phenomena. Chairman Volcker also testified that nonbank bank operations are still relatively small, that the horse isn't out of the barn, if the Congress acts now.

Priority Number 12

HIGH RISK OCCUPATIONAL DISEASE NOTIFICATION AND PREVENTION ACT. The High Risk Occupational Disease Notification and Prevention Act establishes a new federal program to individually notify past and present employees who are more likely than similar populations to develop an occupational disease. The employee is then encouraged to undergo medical monitoring. The present employer must pay for the tests unless that employer was not the one responsible for an exposure to the particular hazard associated with the disease. The bill also establishes an eight member Federal Risk Assessment

Board in the Department of Health and Human Services to assess health studies and determine which employees are in the increased risk groups. Eventually, each state would have an occupational and environmental health center with research authority and access to all federal employment-related files.

The bill authorizes a government expenditure of $25 million for each of two years, but estimates are that the costs will actually be much higher. The government has not even assessed the costs to the nation's businesses or the unemployment which will result. In addition, the legislation would increase the cost of worker's compensation and health insurance and escalate the liability suit crisis according to insurance industry estimates.

The bill places administration of the program within the Department of Health and Human Services and places the enforcement authority in the Department of Labor.

Moreover, there is no indication that the Occupation Disease Notification Act will give any protection. It merely requires the employee to be notified that if he has an occupational disease, it could have been caused by his occupation and it suggests medical monitoring.

The risk factor is arbitrary and is a low correlation without any scientific cause and effect to base it on. In addition, there is not control factor to account for the effects of smoking and diet.

The proponents of the bill declare that its primary purpose is to detect and prevent cancer, but only five percent of cancers in our society are occupationally related as was pointed out in the 99th Congress.

The need for addition health centers and expenditures of these federal dollars during this austere time has not been demonstrated. The few hearings held brought forth no testimony to indicate that current hospitals or medical clinics are incapable of medically monitoring or evaluating notified workers. Existing hospitals are capable of dealing with the medical needs of notified workers.

The Department of Labor, in May of 1986 broadened and strengthened the OSHA Hazard Communication Standard to require employers who manufacture, distribute and import hazardous substances to notify employees of health hazards in the workplace and train those employees in how to handle those hazards safely. OSHA is in the process of expanding the scope of coverage of the rule to all workers exposed to hazardous chemicals. In addition, more than 35 states and localities have similar laws. This approach should be given a fair opportunity to work before we add a complex, costly, and untested program of post-exposure risk assessment and notification.

Priority Number 13

FAIR LABOR STANDARDS. Small business has a substantial stake in national policies which have a significant effect on the cost of labor. Small business is a proven job creator and labor intensive. The SBLC will not support proposals which will dramatically increase the cost of labor, in the absence of compelling evidence such initiatives will advance social and economic goals.

Federal policies which have a direct impact on the cost of labor evolved in response to particular concerns. SBLC believes it is appropriate for Congress to reexamine whether there are alternatives which will allow employees to earn a fair wage, advance societal goals and allow small businesses to add new jobs in the economy. Rigid rules, which once made sense, no longer permit the U.S. to remain competitive and no longer serve the purpose for which they were established.

Priority Number 14

RETIREMENT, SAVINGS AND EMPLOYEE BENEFIT PLANS. Congress and the Executive Branch should eliminate those laws and regulations that discourage the creation and maintenance of retirement and savings plans by small business, and instead enact laws that encourage the creation of these plans.

The Small Business Legislative Council supports a voluntary, private pension system, and supports Congressional and Executive branch actions that would:

1. Repeal top-heavy rules

2. Establish contribution levels for small business plans that recognize that these plans are established to ensure the retirement security of the small business owner as well as his or her employees. These levels should be at least at the level established in the original ERISA legislation of 1974 for defined benefit and defined contribution plans, and at the pre-1987 levels for IRA's, and 401(k) plans.

3. Eliminate, or ameliorate, the bias against defined contribution plans, such as profit sharing plans, which are recognized as the type plan that is most likely to be established by small business. (For example, the Office of Advocacy of the Small Business Administration recommends greater encouragement of defined contribution plans in small businesses as the best way to increase private pension plan coverage to small business employees.) This bias was most evident in the 1986 Tax Reform Act, with its many provisions that complicate the establishment and maintenance of defined contribution plans, such as severe restrictions on a participant's access to his or her money in such a plan.

4. Allow a small business to utilize comparable plans.

5. Eliminate all new taxes imposed on plans in the 1986 Tax Reform Act.

6. Reform the multi-employer pension laws to curtail or eliminate withdrawal liability for small business.

7. Stop needless, and theory-driven changes to the laws governing retirement, savings and employee benefit plans subsequent to the changes outlined below.

8. Examine the impact on small business defined benefit plans of altering pension benefit guaranty corporation premium system from a fixed uniform premium rate for all plans to a variable rate for plans based on plan funding.

Subsequent to the passage of the Employee Retirement Income Security Act (ERISA) of 1974, Congress and the Executive branch of government have enacted laws and regulations that discourage the establishment and maintenance of retirement and savings plans by small business. As a result, the number of employees of small business covered by any private pension plan has remained low when compared to the numbers of covered employees of large businesses. The new laws enacted since 1980 have made the situation worse. There is evidence that the number of employees of small businesses that are participants in a private pension plan, already low, is dropping even more. This trend threatens the very existence of the nation's voluntary private pension system. This trend may lead to misguided efforts to impose costly mandated pensions on small business, or to make small business pay even higher Social Security taxes.

Federal policy makers do not understand, or do not appreciate, why small business owners establish retirement, savings, or employee benefit plans; nor do they understand the vast differences between the small business plans and those same plans in big businesses. For example, the numerous, frequent, and complex amendments to the laws regulating these plans are devastating to small business because these changes impose very high administrative costs on the small business owners.

Priority Number 15

ECONOMIC POLICY: UNDERSTANDING THE NEW AMERICAN ECONOMY. Be it resolved that Congress shall establish a blue ribbon commission to identify the impact of services, information and emerging technology sectors of the American economy. This commission shall be composed of both private and public sector representatives, including members of Congress. Its mandates shall include:

a. reviewing existing Standard Industrial Classification (SIC) codes to identify the magnitude of "America's Statistical Gap" and to make recommendations with regard to appropriate federal legislation and regulations that will ensure proper classification for all industries; and

b. reviewing all other aspects of federal policy affecting services and new technologies, including such areas as tax, credit and capital, regulations, procurement, research and development, intellectual property, trade, education and training, international competitiveness, measurements of productivity and loss of productivity due to problems with childcare.

The commission's final report to the President of the United States and to Congress would recommend a series of specific legislative and regulatory changes in data gathering, economic, tax, procurement, trade and other policies to foster, rather than impede, these dynamic new sectors of the economy.

Be it further resolved that Congress shall enact legislation directing the Executive Branch to create, as a successor to the SIC codes, a new data collection and dissemination system that will:

a. evolve with the continuing growth of the American economy.

b. allow for crosswalking among all major federal data systems-including but not limited to "old" SIC codes, government procurement systems, contract tracking, management information systems, and internationally traded goods and services-incorporating where possible all relevant international data systems.

c. Identify the amount of commercial economic activity performed in the not-for-profit, franchise, and similar sectors.

d. Be updated as to data collection methodologies on a regularly scheduled basis.

e. Provide to the entire business community, through a specified governmental source, appropriate and timely access to all background information.

While the federal government produces bales of statistics, comparatively little useful information is available on economic growth, innovation and emerging sectors of the economy. This is because much of our economic data collection is based on antiquated assumptions and methods developed in the 1930's.

A prime example of what has been referred to as "America's statistical time warp" is the Standard Industrial Classification Code, a set of more than 1,000 four-digit numbers used to classify U.S. industries and keep tabs on economic output. Established in the 1930's and updated every 15 years, we believe the present SIC Code seriously underrepresents the new services, information and high technology sectors of the American economy.

The goods producing sector is represented by 599 different industry categories, though it provides only 27 percent of employment and 33 percent of GNP. The newer services sector, by contrast, is represented by only 423 industry categories in the SIC, even though it contributes 70 percent of the jobs and two-thirds of the GNP. Older sectors of the economy such as agriculture are broken down in such rich detail that one can tell whether a tomato has been grown indoors or in a field. But in newer sectors such as services, a vast array of industries are listed under "services--not elsewhere classified"--a catchall which includes nuclear scientists and songwriters, art restorers and industrial psychologists, and cloud-seeding companies.

This outdated statistical framework is grossly inadequate to support development of sound economic, tax, trade, procurement and regulatory policies. The lack of sound data is a practical barrier to understanding the true nature, dimensions and character of the new American economy and its dynamic entrepreneurial sector.

While the Office of Management and Budget is expected to announce its 15-year revision to the SIC Codes in 1987, these are again expected to be modest revisions at the margin, which in the view of industry experts in newer sectors will still provide a "rearview mirror of the American economy."

Priority Number 15

POLYGRAPH LEGISLATION. The Small Business Legislative Council endorses federal legislation establishing minimum standards for the utilization of polygraphs in the workplace. Any such legislation must permit continued use of polygraphs for pre-employment screening, random testing, and incident specific testing. The administrative-regulatory requirements of legal compliance must be reasonable ones, and not so complex or expensive as to effectively preclude meaningful employment use. To the maximum extent possible, such legislation should treat all employers in an equal fashion and permit no substantive exemptions from its provisions.

An alternative legislative approach of minimum legal standards should be developed. As part of its provisions, it should:

a. Set professional standards for polygraph examiners.

b. Prohibit certain categories of inquiry such as political, sexual, or religious oriented questions.

c. Set limits on the proper use of exam results (e.g., tests could not be the sole reason for dismissal or failure to hire).

d. Preempt less stringent state regulations.

Priority Number 16

FULL AND OPEN COMPETITION IN FEDERAL PROCUREMENT. The small business community has championed full and open competition in the Federal procurement market in the belief that small business government contractors can efficiently meet the Government's requirements as prime contractors, subcontractors, or suppliers. Such expanded small business participation fosters the competitiveness of American business and contributes to the maintenance of the Nation's defense industrial base.

Congress has responded by enacting fundamental procurement reform legislation to assure full and open competition in the federal market and to eliminate barriers to small business participation: the "Competition in Contracting Act of 1984", Tile XII of Public Law 98-525; and the "Small Business and Federal Procurement Competition Enhancement Act of 1984", Public Law 98-577. However, it is essential that Congress closely monitor the implementation of these statutes. To this end, the responsible Committees of Congress should conduct vigorous oversight, and if need be, consider additional legislation, to assure that:

1. the Government-wide Federal Acquisition Regulation (FAR) and FAR supplements issued by individual departments and agencies faithfully fulfill the letter and spirit of the statutes they are designed to implement;

2. the Administrator of the Office of Federal Procurement Policy (OFPP) undertake a vigorous effort to curtail unwarranted FAR supplements and seek to consolidate such unwarranted departmental coverage in the FAR, to present "one-face" to industry to the maximum extent possible;

3. the newly created Under Secretary of Defense for Acquisition undertake a similar effort to curtail the Military Services and the Defense Agencies from issuing their own supplements to the Defense Department FAR Supplement (DFARS) and that such existing supplements be carefully reviewed for elimination;

4. procuring agencies make greater efforts to forecast their anticipated requirements and publish these estimates so that small business contractors can obtain a "long range view" of the potential market and make an informed business judgment to compete; that procuring agencies collect and publish procurement information by acquisition method codes, including the dollar value as well as the number of items in each category, and acquisition method suffix code;

5. procuring agencies made minimum use of contractor prequalification requirements, conduct such prequalification activities in conformity with legislative requirements, and develop procedures that will permit contractors to become qualified for groups of similar items, so-called "generic qualification" or for those they have indirectly supplied as subcontractors;

6. the Department of Defense sustain its efforts to improve its management of technical data so that prospective competitors may have timely access to complete and current technical data packages suitable for competitive procurements; that government owned technical data be included in bid sets and that GAO study the feasibility of contracting out data management;

7. the Executive departments and agencies acquire technical data, including proprietary technical data (with fair compensation to the contractor), and special tooling and test equipment to permit competitive acquisition of future requirements, when such items are likely to be needed in substantial quantities to maintain a major system during its expected service life;

8. the Executive departments and agencies, especially the Department of Defense, maintain, and where appropriate expand, their competition advocacy programs;

9. concerted efforts be made to simplify and standardize the regulations, procedures and forms relating to "small purchases" (under $25,000), which constitute 98% of the Government's procurement activity, especially through the use of automation;

10. the various programs to foster small business participation in the Federal procurement market be fully supported;

11. enact Regulatory Flexibility Act amendment to permit judicial review of agency determinations that a rulemaking effort is not subject to RFA because it has no impact on small business; and

12. the impact of recent procurement legislation enacted without the benefit of hearings is evaluated. Such legislation includes PL 98-94 provisions regarding release of technical data subject to export control as well as provisions of PL 99-661 which raise CBD synopsis threshold to $25,000, place a time limitation on government right to challenge a contractor assertion of rights in technical data, require negotiation of rights in data for items developed with mixed funding and increase charges for technical data needed to bid. It also includes increased FOIA charges enacted as part of the Anti-Drug Abuse Act of 1986.

Priority Number 17

THE MAINTENANCE OF REASONABLE THIRD CLASS POSTAGE RATES. The Small Business Legislative Council supports the maintenance of reasonable third class postage rates and opposes any attempt to make regular rate mailers subsidize postage for non-profit competitors.

Congress should not compel regular rate mailers to pay higher postage rates to subsidize non-profit organizations. If Congress decides it is in the public interest to maintain reduced postal rates for non-profit organizations, the burden of maintaining those lower rates should be shared by all taxpayers and federal funds should be appropriated to continue the subsidy. If the budget does not continue funding for preferred postage rates, then the non-profit postal rates should be raised to make up the postal revenue shortfall. Congress should take action to prohibit the use of subsidized non-profit postal rates for commercial purposes. Eligibility for non-profit mailing rates should be based on the contents of the mailing and limited to the non-profit purpose of the organization.

Small businesses need affordable advertising alternatives. For many businesses, the cost of advertising in the daily newspaper or broadcast media is prohibitive. Direct mail permits small businesses to target their customers, reach consumers in their trade area, and compete effectively with large businesses and franchise stores.

Postage rates for advertising mail are set by the Postal Rate Commission in a rate case proceeding. These proceedings take place when the Postal Service announces that rates must be raised to continue operations. It is likely that a request for a postal rate increase will take place sometime in 1987.

During the last two rate cases, the newspaper industry aggressively requested large increases in third class postage rates. Such an increase would permit newspapers to raise their advertising rates because advertisers would have no competitive advertising alternative. The highest rates would undoubtedly be passed on to small businesses that do not have the bargaining power to negotiate for lower rates or the funds to switch to other media. The Postal Rate Commission must be made aware of the importance of reasonable postage rates to advertisers and, in particular, small business.

Small business may be facing an effort in 1987 to increase postage rates to cover part of the costs for subsidized mailings by non-profit organizations . In the past, low subsidized rates for non-profit organizations have been made possible by Congressional appropriations from taxpayer funds. This appropriation is known as the revenue foregone appropriation.

Over the past few years, the volume of non-profit mailings has increased so that the amount of the revenue foregone appropriation has been nearly $1 billion. Many of the mailings made by non-profit organizations offer goods and services that compete with for-profit businesses that pay full postage rates.

The Administration's fiscal 1988 budget proposal recommends eliminating the revenue foregone subsidy for non-profit mailings but suggests that the low non-profit rates be continued. This could only be done if the Postal Service raised postage rates for regular rate mailers to make up the postal revenue shortfall from the mailings of non-profit organizations.

Any increase in postage rates is a burden for most small businesses. If the government determines it is in the public interest to maintain reduced rates for non-profit organizations, this cost should be shared by all taxpayers. It should not just be passed on to those persons who depend upon the Postal Service.

At the present time, eligibility for subsidized postage rates is based solely on the organization conducting the mailing. Non-profit organizations can promote the sale of goods and services--even when these activities compete with small business--at subsidized rates. A law prohibiting non-profit organizations from using subsidized mail for commercial purposes would reduce the overall cost of subsidized mailings and eliminate unfair competition.

Priority Number 18

POLLUTION LIABILITY INSURANCE. The availability and high cost of pollution liability insurance reached crisis proportions in 1984, and the insurance industry and experts alike hold out little hope for improvement in the future. Like other areas of insurance, the causes of the pollution liability crisis are complex. The liabilities imposed by Superfund, judicial decisions expanding the scope of coverage beyond that which was intended when the policies were written, lack of reinsurance, unwise investment decisions on the part of insurance companies, and ineffective regulation on the state level have all been cited as reasons for the turmoil in the pollution liability insurance market.

While differences of opinion may exist with regard to the cause of the problem, there is little dispute about the serious effect of the unavailability and high cost of pollution liability insurance upon small businesses throughout the United States. Premium increases of between 50 to

200 percent are being reported in certain lines of insurance; and policies are being cancelled and non-renewed at similar rates. Hardest hit are those small firms such as service station owners and operators, garages, fuel oil dealers, dry cleaners and laundries to whom insurance is an essential element of survival because of the nature of the materials they handle or the wastes they produce. The inability to secure pollution liability insurance at affordable rates forces these firms who, unlike large companies, do not have the financial wherewithal to self insure, either to discontinue operations or "go bare". A small firm in the business of handling hazardous materials without the benefit of insurance poses a risk not only to its own financial affairs, but also to the public in general. The inability to obtain adequate liability coverage also severely affects the borrowing power of small businesses. This is an especially critical problem to those firms in need of financing to comply with governmentally mandated environmental protection programs.

In order to address this urgent problem, the SBLC urges the following steps.

1. Adoption of a federal reinsurance program under which the government would assume some of the risk undertaken by insurance companies in high-risk lines of liability coverage. Under this plan, the government would have the authority to offer reinsurance to insurers for groups in need of pollution liability coverage.

2. Establishment of an advisory task force to advise the legislative and executive branches of government on solutions to the pollution liability crisis and to assist in the implementation of those measures.

3. Establishment of a temporary federal moratorium on or suspension of any requirements for minimum levels of financial responsibility for affected industries until the crisis abates.

Priority Number 19

IMPROVED COPYRIGHT AND PATENT PROTECTION FOR SMALL BUSINESS. Protection of intellectual property in the form of patents, trademarks, copyrights, and technical data is critical to the growth of small business. Congress and the Federal agencies should work to protect intellectual property rights of American small businesses at home and abroad by:

1. Implementing a system of equitable fees and accelerated approvals for patents.

2. Accelerating district court handling of patent, trademark and copyright litigation.

3. Collecting data on, and enacting legislation to protect, new U.S. technologies under the intellectual property law system.

Priority Number 20

UNCOMPENSATED OVERTIME. The Federal government should utilize the 40-hour work week as the basis for competition for contract awards.

Additional Issues Not Ranked by Priority

DRUG FREE WORKPLACE. The use of drugs is a serious problem in our society and all segments of our society must cooperate in an effort to find solutions to the problem. Small business has an important stake in the outcome which goes beyond the duty of every citizen to make our society drug free. Small business is not immune from the effects of drugs in the workplace. Drug usage effects productivity, it endangers the safety of fellow employees, and it creates an environment for other problems in the workplace. At the same time, small business does not have the resources to develop and implement programs to insure a drug free workplace. Solutions are required which recognize the needs and conditions of a small business environment.

ESTABLISHING A SMALL BUSINESS REGULATORY AGENDA. Legislation such as the Regulatory Flexibility Act, the Equal Access to Justice Act, and the Paperwork Reduction Act now the law of the land, helped create a "healthier" regulatory and policy environment for small business.

A right of judicial review of the Regulatory Flexibility Act should be extended to cover any action of the Federal government which has an impact on small business; the Equal Access to Justice Act should be extended to cover any "adversarial" situation involving the Federal government and small business as parties; and all Federal agencies shall created a senior executive position, reporting directly to the head of the agency, to service as a representative of small business to assure direct access to the policy making process.

It is difficult to anticipate all of the substantive regulatory issues which might have an impact on small business in the next decade. Therefore, to the extent we can create a permanent framework for small business participation in the decision making process we will ensure appropriate consideration on all major policy issues.

We must create an internal structure to ensure an awareness of small business which goes beyond compliance with the mechanics of small business related laws. Agencies are generally not sympathetic to, or fail to fully understand, the particular concerns of small business.

COMPARABLE WORTH. Employers must continually reaffirm their commitment to the goal that all workers, regardless of sex will be treated equally in every phase of employment. However, job duties and responsibilities of employers vary in each small business and do not lend themselves to standardized job description or job evaluation systems based on a standard format. Flexibility and innovation are the bulwarks of small business success. All encompassing, government mandated efforts such as comparable worth stifle small business growth without achieving their objectives. SBLC opposes any effort to mandate such programs.

Chairman LaFalce. We thank you very much, Ms. Price. Our next witness will be Mr. Francis Carroll, president of the Small Business Service Bureau in Worcester, MA.

TESTIMONY OF FRANCIS R. CARROLL, PRESIDENT, SMALL BUSINESS SERVICE BUREAU, INC., WORCESTER, MA

Mr. Carroll. Good morning, Mr. Chairman, and other members of the House Small Business Committee and staff. I, too, would like to congratulate you, Congressman LaFalce, on your chairmanship. From my recollection of your background, you take on every job with a great deal of enthusiasm, so I know that we are going to have an extremely active chairman.

My name is Frank Carroll, and I am president of the Small Business Service Bureau. SBSB is an organization representing over 35,000 small businesses which are mom and pop companies from across the United States.

I have been actively involved in the SBA activities as a member of the SBA's National Advisory Council since the Ford Administration. My perspective is somewhat unique, because I see the SBA from both the inside and the outside.

I would like to thank the committee for its exhaustive efforts in recent years on behalf of the SBA. Our members, 79 percent of whom want an independent SBA, appreciate your work to maintain the agency as a voice for small business in Washington.

While we applaud the administration's decision to retain the SBA, we feel that some of the proposals in the 1987 Federal budget could make essential SBA services inaccessible to small firms, particularly those very small companies who have 10 or less employees. I would like to discuss how some of these proposals will impact small companies and offer suggestions for making SBA programs and services more efficient and effective for small business.

First, to offset many negative effects of the budget proposals, the SBA should scale down its size standards to service truly small firms with 100 employees or less. And we realize that it may be necessary to adjust these for procurement purposes. According to the SBA's own figures, 98 percent of the Nation's 7.4 million businesses have less than 100 employees. So it only makes sense to concentrate the agency's limited resources on these sized firms.

The SBA is the only agency that specifically serves small business. Now that the SBA is secure, at least for the immediate future, it should be redirected to serve the businesses that it initially intended to serve.

A positive step in this direction is the administration's proposal to limit 90 percent guaranteed loans to amounts under $100,000. A reduction in SBA guarantees on large loans is appropriate because larger established companies can better withstand the rigors of business ownership.

Next, we do support the privatization of some of SBA's portfolio. For example, the Small Business Development Centers could be eliminated, because we feel that they directly compete with the private sector.

The recent success of SBIC's in debenture offerings in the public market is proof that public programs can enjoy success in the private sector. We hope that SBIC's remain an integral part of the venture capital community while operating free of Government control.

Instead of subsidizing universities through the SBDC program, the SBA should let unpaid volunteers such as the Service Corps of Retired Executives [SCORE] provide free service to small firms which cannot afford to pay for management assistance.

A recent survey that we conducted showed that 86 percent of SBSB members want the SBA to utilize these volunteers whose expertise has aided and even saved countless small firms. A revitalized SCORE program focusing on SBA loan recipients, for example, would reduce the potential for bankruptcies, thereby making small firms less likely to default on SBA loans.

The SBSB also supports the budget proposal to shift Minority Business Development Centers from the Commerce Department to the SBA. There is currently much overlap and wasted money in the MBDC Program, because many of its services are already offered by the SBA. Providing assistance to minority firms should be a priority of the administration, but duplicating programs does not help minorities or taxpayers.

The SBSB strongly opposes the administration's proposal to increase guaranteed loan fees from two points to four points with the lender paying one point. Lenders will be less likely to provide loans if they must pick up 1 percent of the fee. In addition, if lenders do provide a loan, that one point fee will probably be passed on to the borrower in the form of high interest rates.

On an SBA loan of just $50,000, for example, the small business owner would be faced with a borrowing fee of $2,000. This may be nothing to someone like Chase Manhattan Bank, but $2,000 is critical to small firms struggling to meet their payrolls.

Every day at SBSB, we help startups obtain loans. We have seen firsthand how banks are shying away from SBA loans, because of the enormous amount of paperwork and bureaucracy involved. Increased borrowing fees will only further discourage banks from providing SBA loans.

The SBA program is still the best source of long term business capital. Let's not price it out of the market. The small business community won a great battle when the administration relinquished its plans to eliminate SBA.

We agree that some budget cuts and consolidation are needed to make the SBA a more efficient Federal agency. However, we must not allow administration budget cutters to make the agency inaccessible to the thousands of small firms that need its services.

Attempts to eliminate or slash the SBA's budget are examples of the administration catering to big business concerns at the expense of small business. With the SBA safe for the immediate future, now a similar situation has arisen in the area of health care.

The number one issue facing small business owners today is access to quality, affordable health care for themselves and their employees. There are several proposals being considered by Congress which will determine the future direction of this country's health care system.

There is an immediate serious problem facing small business in America today. The problem is the big business attempt to decrease their HMO insurance premiums and increase HMO premiums for small business.

Big business acting through their agents, the Washington Business Group on Health, have pressured HCFA, the Health Care Financing Administration of the Department of Health and Human Services, to propose the repeal of existing equal contribution regulations in section 110.808 of the HMO Act. The changes call for an immediate public response, unfortunately, by March 16th. They tried to sneak this one through.

I am calling on you, the Members of the Congress, the Small Business Committee, Mr. Heatherly and Mr. Swain, our SBA advocate, and my colleagues from other small business organizations to use all of our resources available to help our small business constituents by preventing the repeal of section 110.808 by March 16th.

Under this proposal, gentlemen and ladies, employers would no longer be required to contribute the same per-employee amount to federally qualified HMO's as they contribute to the more traditional health benefit plans that these companies provide.

Big business would then be able to decrease their contributions and shift the cost, thus increasing the HMO premiums to small business, the working poor, and the elderly. Increased HMO premiums would act as a disincentive to join an HMO plan. This is purely a big business proposal, and it is bad public policy that is inconsistent with the intent of the United States Congress when you passed the HMO Act.

In closing, the political atmosphere as we can see during the last six years has favored big business. The 100th Congress now has the opportunity to help small business. Many of the issues that we have discussed here today are perceived as anti-small business.

Congress needs to take a closer look at the impact that these proposals will have on American entrepreneurs. The committee can play a major role in ensuring that America's small companies get the fair treatment that they deserve. Thank you.

Chairman LaFalce. Thank you very much, Mr. Carroll. Our next witness will be Mr. Warren Purdy, director of the SBDC at the University of Southern Maine, Portland, ME, and president of the Association of Small Business Development Centers.

TESTIMONY OF WARREN G. PURDY, DIRECTOR, MAINE SMALL BUSINESS DEVELOPMENT CENTER, UNIVERSITY OF SOUTHERN MAINE, PORTLAND, ME; AND PRESIDENT, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS, WASHINGTON, DC

Mr. Purdy. Mr. Chairman, thank you for the opportunity to appear before you today. I am Warren Purdy, president of the Association of Small Business Development Centers. I also serve as State Director of the Maine Small Business Development Center, one of the oldest university based entrepreneurial assistance programs in existence in the country.

Let me begin my statement by saying that there is an urgent need for a general oversight hearing by your committee to examine the state of the SBDC program. Neither the House nor the Senate

Small Business Committees have reviewed the status of the SBDC program since 1984.

Mr. Chairman, the SBDC program is a creature of Congress. As are most other SBA programs, it is providing meaningful cost effective services and capital resources to the Nation's small businesses. The SBA and the executive branch never sought nor wanted the SBDC program. A major reason for the resistance to the program was that to embrace it was to raise questions with regard to SBA's other management and technical assistance programs. Some SBA officials also held an unfounded belief that as the individual State SBDC's grew stronger and demonstrated their prowess in delivering diversified, multiple services to its small business constituency, the SBA district management assistance programs would be displaced or at the very least lose standing within their respective communities. A third reason has since evolved, and that is some SBA district and regional offices have found it difficult to accept that the SBDC's are not captive of the agency, but rather partners with it.

Recognition of the last distinction is crucial, because Congress explicitly created this program as a partnership effort which means that both parties, the States and the SBA are treated as equal. I should note parenthetically that State and private sector resources now far exceed the Federal contribution. Both types of resources have rightfully insisted on working in harness with SBA in establishing individual State program goals and priorities.

It is important for this committee to understand the reasons for the executive branch's less than enthusiastic support for this program, because it helps explain the SBA's SBDC fiscal year 1988 budget recommendations.

The SBA's top officials and the OMB budget officer responsible for SBA desperately want the SBDC program eliminated. For the last two years, these people thought they could easily achieve this goal as a by product of simply doing away with SBA. Much to Congress' credit, the proposal to pull the plug on SBA was not enacted. This year these same individuals have attacked SBDC's on two fronts to achieve what they were unable to do in the prior two years. First, they have urged that the population funding formula used to determine a State's eligibility for Federal matching funds be reduced from $65 to $45 million.

Mr. Chairman, the net effect of this proposal is that 26 States would suffer a 50-percent Federal funding reduction in the first year. We have attached a list of those States. An additional number of States will also experience severe budgetary cuts.

Let me make it crystal clear at this juncture that should States experience a 50-percent cut in Federal matching revenues, a wholesale termination of SBDC's as we know them will occur across the country. Even though many States and other funding partners provide far more matching resources than does SBA, the Federal match still plays an indispensable catalytic role.

The second frontal attack by SBA on the SBDC program is a proposed set of comprehensive regulations that would give SBA license to micro-manage the program in utter disregard for State needs, Federal law, State constitutional requirements and prohibitions, and the governing OMB circulars that have been carefully developed over a period of years.

You should be aware that what the agency has been unable to achieve through its own self-destruction or should its budget recommendations not be accepted by the Congress, it will nevertheless be able to accomplish this by adopting final regulations in mid-1987. Simply stated, these abhorrent regulations will preclude many States from continuing the SBDC program. And those SBDC's that remain will be so severely constricted that in all likelihood they will have no chance but to call it quits in a short period of time. Attached as an addendum is our letter of comment on the proposed regulations submitted to SBA on January 27, 1987.

In our opinion, the most important question the committee must presumably decide in the near term is whether the program merits your continued support by not agreeing to SBA's budget recommendations. We hope that last year's track record alone will justify a repudiation of SBA's budget recommendations. In fiscal year 1986, 43 SBDC's counseled over 70,000 small businesses and provided training to another quarter of a million would-be entrepreneurs and smaller growing firms. This level of activity, although inconsequential, is but a small measure of the multitude of economic development services currently being rendered by 49 SBDC's operating in almost 600 cities and towns.

The promise of this program has been fulfilled in that the SBDC's have designed tailor made solutions that are responsive to the unique needs of their respective communities be they industrial or agrarian based, densely or sparsely populated. Our program has also been used as a role model or by other nationally and internationally sponsored programs as we have demonstrated that one can create comprehensive economic development services by leveraging university, State, and private sector financial and human resources.

Mr. Chairman, public sector programs are unlike private businesses which have stockholders demanding reports on their investment. As a result, few Government-sponsored programs ever attempt to assess whether the end users are realizing any benefits; and if so, identify the cost/benefit ratios. We have. Beginning in 1982, SBDC directors across the country began studies to determine the program impact on small businesses within their States. The first study of clients counseled in 1980 and 1981 in 10 States conservatively estimated that over 10 new tax dollars were generated annually for every dollar expended by the SBDC's. Several States have individually assessed their programs since then, reaffirming the original findings. Last year, the ASBDC initiated an impact study of long term counseling in nine States for calendar year 1983, and found that nearly $9.5 million in new taxes were generated by the firms responding to our surveys. If extrapolated to all long term clients counseled in those States, the total net increase in taxes paid would amount to $43 million at a cost of only $2.1 million. Documentation for these studies can be obtained through our association offices or from the various participating State offices.

I caution that this recent analysis should not be treated lightly, for no other SBA program to our knowledge, with the exception of the procurement breakout program, has ever dared to measure various indices to determine whether it is having a positive beneficial impact. This one has and we believe that the record speaks for itself.

I only wish space would allow the record to include the dozens of annual reports from SBDC's because they would illustrate the diversity of services provided in our respective States. However, if it would be helpful to the members of the committee, we would be delighted to furnish a packet of recent annual reports to individual committee members, so that they might better appreciate that no other governmental or private sector program is furnishing the kinds of services that we offer.

To further assure program integrity, SBDC directors and SBA personnel undertake periodic onsite peer review visits to examine in depth the organizational structure and service delivery methods within SBDC's. Last year, we completed reviews of 15 programs and this year, if SBA permits, we will examine 23 other SBDC's. Our association has also begun its own certification process which imposes much more rigorous standards than does SBA.

There are many aspects of the SBDC program that I would like to address this morning, but time does not permit. They will simply have to wait until you hold an oversight hearing on the program, which as you can tell, we are eager to have happen as soon as possible.

In closing, Mr. Chairman, the proof in the pudding is that hundreds of thousands of small business men and women today are seeking SBDC assistance. Other tens of thousands are being denied this assistance because we do not have sufficient resources to meet the demand. Although we recognize the very serious budgetary problems confronting the Federal Government, the truth is greater resources are needed for the program.

In the final analysis, small businesses simply cannot afford to have SBDC's wind down either through budget cuts or suffocating, capricious regulations that make a mockery over 10 years of the experience with our Federal partner.

Mr. Chairman, we continue to need your help and support. Thank you.

[Attachments to testimony follow:]

ADDENDUM

STATES REACHING THEIR FEDERAL FUNDING CAP IN FY 87

ALABAMA

ALASKA

ARKANSAS

DELAWARE

WASHINGTON, D.C.

GEORGIA

IOWA

KANSAS

KENTUCKY

MAINE

MINNESOTA

MISSISSIPPI

MISSOURI

NEBRASKA

NEW HAMPSHIRE

NEVADA

NORTH DAKOTA

OREGON

RHODE ISLAND

SOUTH DAKOTA

UTAH

VERMONT

VIRGIN ISLANDS

WEST VIRGINIA

WISCONSIN

WYOMING

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January 21, 1987

Ms. Johnnie Albertson
Deputy Associate Administrator for
 Business Development
U.S. Small Business Administration
1441 L Street, NW, Room 317
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RE: Proposed Rule to Govern the Operations of the Small Business Development Center Program

Dear Ms. Albertson:

This letter of comment, filed on behalf of the 43 members of the Association of Small Business Development Centers (the Association) and reflecting their collective view, is in response to the Small Business Administration's (SBA) proposed rule that would govern the operation of the Small Business Development Center (SBDC) Program. We strongly believe that the rule should be withdrawn.

Our comments are divided into two parts. First, the Association addresses the agency's perceived need for the proposed regulation and analyzes how the regulation is contrary to applicable laws and policies. Second, the Association has undertaken a section-by-section analysis of the proposed regulation and how specific provisions will disrupt the SBDC Program and undermine its objectives.

I. THE PROPOSED REGULATION IS CONTRARY TO THE INTENT OF THE LAW ESTABLISHING SBDCs, INCONSISTENT WITH THE ADMINISTRATION'S STRONG COMMITMENT TO ELIMINATE BURDENSOME REGULATIONS AFFECTING SMALL BUSINESSES AND OTHERWISE ILL-CONCEIVED

SBA's proposed regulation governing SBDCs is not appropriate or justified. President Reagan in submitting his report on The State of Small Business to the Congress in 1986 stated:

> Continued steps to reduce regulatory burdens are important to a healthier small business climate. I call on all Federal agencies to continue to fight to eliminate burdensome regulations and to look askance at proposals for solving every problem with a Federal regulation. The Regulatory Flexibility Act, an important tool for agencies in this effort, requires economic analysis of small business impacts and the consideration of less burdensome alternatives.

If words and commitments to small business have any meaning, SBA should never have allowed this proposed regulation to go forward. It is particularly troubling that repeated efforts by representatives of SBDCs and the small business community to resolve specific issues short of a new regulation have thus far been rejected. Even more alarming is the SBA's justification for a sweeping new regulatory scheme:

> The increased size of the Small Business Development Center program over the last few years has necessitated the promulgation of regulations to insure that the program operations are uniform nationwide. (Emphasis added.)

The illogic of considering a Federal regulation to dictate uniform terms and conditions to the state and university partners of the Federal government in administering an SBDC Program under Cooperative Agreements raises the most fundamental questions about the Federal relationship with these administering entities.

To understand how basically wrong it is for SBA to try to impose additional regulatory requirements on SBDCs, it is useful to review the statute which established the SBDC Program in 1980 (P.L. 96-302), subsequent reauthorization legislation (P.L. 98-395) and related legislative history. Without attempting an exhaustive analysis of the laws and their intent, we cite relevant excerpts which establish how the proposed regulation is contrary to what Congress intended. For example, in Senate Report 98-309, Congress states clearly its intent to encourage as much diversity in the program as there are states participating, not national uniformity.

> "It was never the Congressional intent that all SBDC's would operate in the same way, or place the same amount of emphasis on any one area of counseling and training. An integral part of the legislation has always been the flexibility given to each center to tailor its assistance and service activities to the actual needs of the clients in that region. Since 1979, the agency and the Committees have witnessed tremendous -- and often diverse -- growth among the SBDC's reflecting the diversity of the various service areas." (Emphasis added.)

To stimulate diversity, flexibility, innovation, decentralization and a partnership relationship, Congress authorized SBA to make grants to a wide range of entities such as state governmental agencies, universities or colleges, state chartered development, credit or finance corporations, or any combination thereof. It was understandable that Congress would provide great flexibility in how the SBDC Program is to operate. The statute contemplated that SBDCs would provide services extremely broad in scope, including assisting small business in solving problems concerning "operations, manufacturing, engineering, technology exchange and development, personnel administration, marketing, sales, merchandising, finance, accounting, business strategy development, and other matters needed by small business for growth and expansion, innovation, increased productivity and management improvement and for decreasing industry concentration." In rendering these services, Congress only required each SBDC applicant to identify the area to be served, the services to be delivered and how such services would be delivered. As part of its providing services, Congress identified areas for advisory services to be rendered: technology transfer and state and Federal regulatory compliance; identifying private sector consultants, professionals, and organizations; coordinating small business research and in-depth surveys; and furnishing one-on-one counseling.

In short, the statute and its legislative history make clear that each participating state, in partnership with SBA, was expected to frame a program designed to address the unique needs of small business within its own jurisdiction. Variations in how the SBDCs would operate would be infinite. Thus, nothing could stray further from the statute and its purposes than an attempt by the Federal government to impose national uniformity and to micro-manage the program through a Federal regulation which dictates virtually every detail of how an SBDC can and must operate.

Congress also was explicit that the SBDC Program would be a partnership between SBA and each participating SBDC. Section 2(2) of P.L. 98-395 specifically mandates:

> "(2) The Small Business Development Center Program shall be under the general management and oversight of the Administration, but with recognition that a partnership exists under this section between the Administration and the applicant for the delivery of assistance to the small business community. Services shall be provided pursuant to a negotiated Cooperative Agreement with full participation of both parties."

Basic to SBA's discharge of its statutory duties has been the need to respect its role as a partner with each state SBDC. The legal framework for the partnership has been captured in Cooperative Agreements, a distinct class of Federal/non-Federal assistance relationships which reflects the need to agree mutually on the nature of both parties' rights. The enactment of the Federal Grants and Cooperative Agreements Act in 1978 (31 U.S.C. 6301, et. seq.) was intended to eliminate unnecessary administrative requirements by properly characterizing the relationship between an executive agency and the non-Federal partner. The specifics of who does what and who is responsible for what is expressed in the instrument that defines the relationship, not in a regulation promulgated by the Federal partner to the agreement. Over many years, the Cooperative Agreement instrument has been refined to allow Federal/non-Federal partners to cooperate on significant mutual undertakings. The Cooperative Agreement provides flexibility to update constantly the relationship in light of experience and make needed changes in a timely fashion. Once rigid requirements are incorporated in a regulation, changes will be possible only through amendments to the regulation -- a time consuming and needlessly burdensome and complicated process. The history of the SBDC Program demonstrates that SBDCs must continue to evolve if they are to respond effectively to the dynamic needs of the small business community during a time of unprecedented changes and challenges. Imposing a regulatory scheme which directs how SBDCs must operate to meet these needs and challenges is counterproductive in the extreme. It does violence to the purpose and meaning of the Federal/non-Federal assistance relationship presently embodied in a Cooperative Agreement with each SBDC.

It is the ultimate irony that SBA, the agency charged with enforcing the Regulatory Flexibility Act (RFA), now proposes a rule that would place such rigid and detailed restrictions on SBDCs as to reduce dramatically their flexibilty to serve the small business community effectively. The controlling standard for determining that the RFA applies to a particular rulemaking is whether the rule will "have a significiant impact on a substantial number of small entities." Since SBDCs' mission is to provide services to small businesses, it is disingenuous in the extreme to certify that the rule will not "have significant economic impact directly on a substantial number of small entities." (Emphasis added). The RFA makes no distinction between a direct and indirect impact as the SBA tries to do in its certification of compliance with the Act. There can be no doubt that the increased administrative burdens levied on SBDCs by the regulation will divert significant time and resources from program activities serving small businesses to reporting and administrative responsibilities that satisfy the bureaucratic needs of the government agency whose mission it is to serve small businesses, SBA. Were SBA to undertake a searching and thorough analysis of the rule's impact (direct and indirect) on the small businesses SBDCs are expected to serve, we are confident that it would conclude that no regulation should be implemented. Such an analysis is required by law.

Having ignored the statute establishing the SBDC Program, violated the Administration's commitment to reduce regulatory and paperwork burdens, and disregarded the Cooperative Agreement and its proper role, SBA also has managed, by promulgating this proposed regulation, to reject applicable OMB Circulars that are based on years of painstaking development and experience by state and local governments, educational institutions, and the Federal government. Inherent in this OMB Circular and legislative standardization process has been the concept of placing greater reliance on non-Federal entities. In the case of state and local governments, the Intergovernmental Cooperation Act of 1967 was passed, in part, for the purpose of achieving greater consistency and simplification in the administration of Federal assistance programs.

Specifically, Office of Management and Budget (OMB) Circulars A-102 "Uniform Administration Requirements for Assistance to State and Local Governments", A-110 "Grants and Agreements with Institutions for Higher Education, Hospitals and Other Nonprofit Organizations", A-21 "Cost Principles for Grants, Contracts and Other Agreements and Educational Institutions", and A-87 "Cost Principles for Programs

Administered by State and Local Governments" are intended to provide direction to the recipients of Federal funds, including those entities administering the SBDC Program. Any changes in the requirements contained in these Circulars has and will continue to be the subject of careful review and deliberation. By way of example, a review of OMB Circular A-102 has been in process for more than two years. Delay in revising Circular A-102 has held up review of OMB Circular A-110. While the President's Council on Management Improvement has established a task force to study Circular A-110, the group will not begin its review of that Circular until after the proposed revision of Circular A-102 is published in the Federal Register. Public comments and suggestions regarding possible changes to Circular A-110 will be solicited. It is important to note that changes made in 1984 to OMB Circular A-122 (cost principles for nonprofit organizations other than educational institutions) have not been made in Circular A-21 governing educational institutions or A-87 governing state or local governments.

In light of the importance the Administration attaches to these government-wide Circulars and its specific commitment to achieving uniformity to a maximum extent when permissible under existing laws, SBA's proposal to add, modify, and change uniform requirements under the applicable Circulars seems highly inappropriate and can only complicate administration of the SBDC Program. Exceptions to these Circulars normally apply only for certain recipients (and not a class of recipient) and only where the Federal agency wants to impose additional requirements on certain recipients, because the recipient has "a history of poor performance, is not financially stable, or its management system does not meet the standards prescribed in the Circular." In these circumstances, the Circular requires the agency to notify the recipient in writing as to why additional standards are being imposed and what corrective action is needed. SBA has failed to demonstrate that any grounds exist to justify imposing additional administrative requirements on SBDCs. Nor does OMB view the imposition of additions to the uniform cost principles favorably. Circular A-21 states: "Agencies are not expected to place additional restrictions on individual items of cost." The irony with the SBDC Program is that the statutory history has provided a legal basis for SBA to reduce regulatory burdens under provisions of existing OMB Circulars -- yet SBA has inexplicably decided to add requirements. The Association believes that there is no justification for requiring universities and state governmental entities to establish special administrative and cost procedures, principles, and policies which are not consistent with well established operating practices and principles applicable to other Federal assistance programs administered by these same entities.

Surely, SBA, the agency dedicated to the interests of small business, can administer a program intended to serve small businesses through existing OMB Circulars, and SBA's Program Announcements, Policy Manual, Standard Operating Procedures, and the Cooperative Agreements. A reexamination of the array of policy and contractual requirements already in place leads to the conclusion that SBA's priority at this time should be simplification and a reduction of Federally imposed requirements.

The pending threat of a new regulation has already interfered with the program mission of the SBDCs and diverted essential time and effort of key personnel away from the task of serving their small business clients. Accordingly, we strongly request that SBA withdraw the proposed regulation and consider ways to simplify administration and reduce the Federal role. Any SBDC Program issue requiring further attention can and should be addressed by appropriate revisions in existing policy guidelines and mutual understandings between SBA and the non-Federal partners of the SBDC Program under individually crafted Cooperative Agreements.

Since the Association has no assurance that its strong views on the inappropriateness of the proposed regulation governing SBDCs will be favorably acted upon by SBA, we offer the following analysis of specific provisions of the rule and how they are seriously flawed. This analysis is by no means exhaustive but is only illustrative of the deeply serious problems raised by the proposed regulation

II. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED REGULATION ESTABLISHES THAT THERE ARE NUMEROUS AND MAJOR DEFICIENIES, FLAWS AND UNWORKABLE REQUIREMENTS

129.10 Introduction

The opening section of the proposed regulation illustrates how confusing and counterproductive it is for SBA to try to modify existing Federal rules and policies with a new regulation. It is difficult to understand both the choice and treatment of subject matter SBA attempts to cover in the introduction.

- It states the SBDC Program is a partnership when, in fact, the proposed regulation supercedes the Cooperative Agreement mechanism with a Federally dictated and administered Program which significantly limits the discretionary authority of SBDC sponsors and managers.

- It states that the SBDC Program is decentralized when, in fact, there is proposed a multi-layered and highly centralized management scheme under the exclusive control of the agency.

- It states that the SBDC Program is only a management assistance delivery program of the SBA when, in fact, it is a joint venture between the Federal government and the states that now collectively sponsor hundreds of diversified small business economic development activities.

- It states final authority for terms of the Cooperative Agreement and establishment of program policy rests with SBA when, in fact, the Cooperative Agreement is, as its name implies, now cooperatively drafted and entered into between two equal partners and program policy is now mutually determined between the two partners, SBA and the host sponsor.

- It states that it is the responsibility of the SBDC to foster a productive relationship with SBI, SCORE, and ACE and that SCORE and ACE representatives should serve on SBDC Advisory Boards when, in fact, SBDCs exercise no authority over any of these SBA sponsored programs. SBDCs are not in a position to enter into a relationship with any of these programs, unless SBA and the on-site managers of those programs and their participants deem it appropriate. The composition of SBDC Advisory Boards should be left to the complete discretion of the states who are in the best position to know the types of representatives needed to make the SBDC as effective and responsive as possible.

129.10 (a) Describing the SBDC Program as a "small business management assistance delivery program of the SBA" is too limiting. The proposed wording suggests a single, limited program objective rather than a program with long-term, flexible growth potential. The proposed language does not accurately reflect Cooperative Agreement activities already being undertaken by SBDCs with the written concurrence of SBA. At a minimum, the paragraph should be reworded to broaden its scope and emphasize the evolutionary role that an SBDC plays in overall small business economic development activities as individual state programs grow and mature. This section should also be clarified to state that each individual state program is managed by the State SBDC Director within the organizational structure outlined in the SBDC Program proposal and that SBA district and regional personnel are responsible only for SBA oversite and representing SBA's interests in the partnership.

129.10 (b) The statement of the SBDC Program purposes is not sufficiently comprehensive. The purposes fail to note, for example, an advocacy function. P.L. 96-302 requires SBDCs to assume an advocacy role, including "providing assistance to small concerns with regulatory compliance" and "maintaining a working relationship with the financial and investment communities and small business groups." In addition, the section, as worded, implies that the SBDC Program potential is limited. It fails to note leveraged, cooperative and supporting relationships with the private sector, as well as other local, state, and Federal programs, aimed at providing services that will aid in the development, stabilization and expansion of small businesses. By suggesting that SBDCs provide only "direct" services to small businesses, the scope and potential of the SBDC Program is seriously understated. (See 129.18 for additional views pertaining to this issue.)

129.10 (c) (1) The final part of this section stating that "the final authority for the selection of SBDCs, the terms of the Cooperative Agreement, and the establishment of program policy rests with SBA" is inconsistent with current SBDC Program administration; fails to acknowledge the partnership relationship with a state or university under a Cooperative Agreement which determines priorities for the SBDC Program; and is too restrictive.

SBA and the SBDCs have collectively worked together to resolve problems as diverse as the on-site review process and develop appropriate evaluation tools and an SBA/SBDC Policy Manual. Each of these issues was cooperatively addressed and jointly resolved to the best possible level of satisfaction at the time. Policy matters such as these cannot be resolved otherwise since the Program operates under the auspices of Cooperative Agreements. Thus, the "final authority" for SBDC Program policy rests neither with SBA nor the SBDCs, but rather is subject to mutual agreement.

Further, Congress specifically directed that each SBDC and SBA shall have an equal role in determining the "terms of the Cooperative Agreement." Section 2(2) of P.L. 98-395 states:

> "(2) The Small Business Development Center Program shall be under the general management and oversight of the Administration, but with recognition that a partnership exists under this section between the Administration and the applicant for the delivery of assistance to the small business community. Services shall be provided pursuant to a negotiated Cooperative Agreement with full participation of both parties."

When Congress decided Cooperative Agreements were to govern the relationship between SBA and a particular state, Congress intended both parties to the agreement to reach mutual understandings about the terms of the agreement.

129.10 (c)(2-3) It is inappropriate to include in a Federal regulation SBDC responsibility to foster productive relationships with SBI and SCORE. Such relationships must be the responsibility of both parties. If SBI and SCORE representatives are not cooperative, no regulation can direct the nature of these institutional and personal relationships. This section is gratuitous and can only lead to misunderstandings.

(ii) The attempt to force membership of any group or organization on a board is inappropriate. Board membership should reflect the interests of the local small business community and should be comprised of those individuals best suited to meet the needs of the SBDC Program and no one else. Further, empirical evidence has already proven that in at least one state, having a SCORE representative on an Advisory Board has been a disrupting factor in meetings.

129.11 Definitions

This section conflicts in numerous and fundamental ways with established government wide requirements contained in OMB Circulars. It raises serious questions about SBA's intent, authority and purposes.

Where SBA's definitions track language in existing OMB Circulars or represent variations thereof, they create unnecessary confusion. If OMB definitions are to be used, then the appropriate definition should merely be incorporated by reference, but not quoted in its entirety. Where changes or totally new definitional requirements are proposed which do not apply presently to state or local governments or educational institutions under existing Circulars, such as the definition of "lobbying", SBA should provide a detailed explanation and justification as to why such a radical departure is warranted for the SBDC Program prior to revision of applicable OMB Circulars.

In the case where the SBDC statute requires a special definition of "cash match", SBA has departed in the regulation from specific language which has already been carefully formulated and approved in final form by the SBA's General Counsel, after protracted discussions with representatives of the SBDCs.

Other key definitions abrogate the premises of the Cooperative Agreement relationship between SBA and individual SBDCs. For example, the definition of "working days" violates both host institutional policies and OMB Circulars. And, the proposed definition of "conflict" poses a unilateral expansion of SBA's jurisdiction and an unwarranted intrusion into the operations of host institutions.

With major changes contemplated shortly in the applicable OMB Circulars, SBA must be particularly careful not to incorporate language which will soon be outdated.

129.11 (c) Cash match: The cash match definition in the proposed rule does not agree with the language in SBA notice 6000-122 issued on October 11, 1986. The language in that notice reflects the cash match definition already agreed to by SBA's General Counsel's Office. We are deeply concerned about the sudden effort to change unilaterally the definition of this very important term.

129.11 (d) Conflict: The definition of "conflict" covering any programmatic disagreement or problem whether pre or post award regarding any matter not addressed in the Cooperative Agreement is too broad. The SBA has no authority over matters outside the Cooperative Agreement unless they are part of the application. Rather than expanding its jurisdiction, SBA should be diligently seeking ways to reduce its role as the SBDCs mature. SBA's role, barring reasons for suspending or terminating an SBDC already prescribed by OMB Circulars, should over time be reduced in scope as experience warrants greater trust and authority being vested in the SBDC.

129.11 (e) Direct costs: This section should reference the appropriate OMB Circulars for the recipient organization.

(i) Full-time employee: This definition conflicts with the directive contained in Title II, Section (c)(2) of P.L. 96-302 requiring an SBDC to "make full use of other Federal and State government programs that are concerned with aiding small businesses." This definition precludes a full-time SBDC State Director from fulfilling his or her legal mandate to manage and utilize these other programs in concert with the SBDC Program to the benefit of the small business community.

Similarly, the definition precludes the State Director from fulfilling his or her obligation under Title II, Section (d) of P.L. 96-302.

Finally, this definition fails to recognize that State Directors are often required by their institutions to teach one course.

129.11 (j) Grant and Cooperative Agreement Disputes Resolution Committee: This committee, made up of only representatives from SBA, is inconsistent with the partnership nature of the program. (See 129.15(c) comment).

129.11 (m) Indirect Costs, (n) Indirect Match and (o) In-Kind Match: These terms are defined in the relevant OMB Circulars and simple reference should be made to the applicable provisions.

129.11 (r) Lobbying: This section should only reference the appropriate OMB Circular for the recipient organization.

129.11 (z) Satellite: This definition creates problems throughout the proposed regulation when reference is made to limitations on subcenters and satellites.

129.11 (dd) Subcenter director: There is no legal or policy basis for arbitrarily requiring a subcenter director to be full-time. P.L. 96-302 requires only a "full-time staff, including a staff director" of a state program. P.L. 98-395 likewise only requires that a State Director be a "full-time staff director." Nowhere is a full-time subcenter director mandated by law or suggested in the relevant legislative history.

129.11 (ee) Working days: This definition dramatizes the mischief created by the proposed regulation. Universities and state and local governmental agencies have established leave policies which may or may not be consistent with the proposed definition of "working days". OMB Circulars A-21 and A-87 state that employee compensation must be consistent with established institution policies. Additionally, fringe benefits negotiated and approved as part of the indirect cost rate by the cognizant Federal agency are based on established policies governing vacations, holidays, sick leave, pension plans and the like. SBA has no authority to depart from approved negotiated rates which have been established. Redefining "working days" to exclude all but "Federal holidays" would affect recipient entities compensation plans and place an unnecessary administrative burden on the recipient institutions.

129.14 Application Procedure

Application procedures for SBDCs have no place in a new Federal regulation. Existing OMB Circulars should apply and the cognizant agency should seek maximum flexibility to specify in its Program Announcement what at any given point in time it requires from an applicant. This section should be deleted in its entirety.

129.14 (a) General: The phrase "state or region" is ambiguous and too broad. Is a "region" an area within a state or is it a geographic area incorporating one or more states? Also P.L. 98-395 reads that "certain states may require more than one funded SBDC in the state in order to insure that small businesses are given access to services," (Emphasis added.) SBA, responding to a question from the Senate Small Business Committee, identified only three states -- New York, California, and Texas -- where there might possibly be a need for more than one SBDC (see legislative history of P.L. 98-395). This section should specifically identify those three states. Further, Congress stipulated that the state's statewide plan was to be the guiding document in determining the number of SBDCs in a state. Thus, more than one SBDC should only be allowed if it is in compliance with such a plan. SBA has already ignored Congressional intent in the case of New York where the statewide plan called for only one SBDC, and not two as is presently the case.

129.14 (b) Contents-(1) General: This paragraph should end with a period after the words "Program Announcement". Paragraphs (i)-(vi) are only appropriate for inclusion in the Program Announcement and therefore should be deleted.

(2) Specific: (i)-(viii): Similarly, these subsections are only appropriate for inclusion in the Program Announcement and should be deleted. To assure operational flexibility and evolutionary change, rigid regulatory requirements should be avoided at all costs.

129.14 (c) Amendment: The reference to unidentified "authorized SBA officials" lacks clarity and should be refined. Further, it should be made clear that an SBDC can file an amendment at any time for SBA's review.

129.14 (d) Competing applications: This section should be reworded to state clearly that competing applications will not be accepted from other entities in states currently operating an SBDC unless a prior decision not to refund the current operating center has been made in accordance with established procedures. Thus, this section would apply only to competing applications from states which do not have operating SBDC Programs, are voluntarily terminating one type of SBDC sponsorship, or are not being refunded for cause.

(3) The reference at the end of this subsection to an existing SBDC being given the opportunity to match a better application presented by a new applicant is disruptive and should therefore be deleted. It is not the SBA's role to promote the submission of competing applications.

129.14 (e) Decisions Not to Refund Previous Program Participants: Subsections (1)-(5) outline a process which provides no avenue for arbitration by an independent board. An appeals process, including arbitration by an independent board, must be established in order for a final decision to be reached.

(5) This paragraph should make it clear that a subcenter of the ongoing organization may apply for designation as a recipient organization only after the refunding of the current SBDC has been denied.

129.14 (i) Unless Form SF912 is required for all recipients of government grants, contracts, and Cooperative Agreements, it should not be required of SBDC participants.

129.14 (k) Conflicts resolution policy: The final resolution outlined in paragraph (3) establishes no time frame. This paragraph should say that "if there is no action on the part of SBA within 45 days, the resolution will be in favor of the SBDC." Further, in paragraph (3) the regional office should deal first with the SBDC Director, then with his or her supervisor.

129.15 Cooperative Agreement

This section adds nothing to the multiplicity of policy documents that already make abundantly clear what policies govern the SBDC Program. Worse, portions of this section are inconsistent with OMB Circulars and establish a one-sided dispute resolution process violating the statutorily mandated partnership nature of the Program.

129.15 (b) Revision to Cooperative Agreement: This section uses an example which violates the applicable OMB Circulars (A-102 and A-110) requirements for making budgetary changes. According to the Circulars, it is not necessary to notify the funding agency of a transfer which does not exceed 5% of the approved total budget. To institute a notification procedure in such cases would be extremely time consuming and serves no useful purpose since approval by SBA is not required by OMB Circulars. The unnecessary administrative burden imposed on SBDCs in notifying SBA of every single minute change in the budget should be avoided. SBA has seemingly ignored GAO and OMB reports in recent years commending universities in their management of research funds. These reports concluded that universities manage their external funds in an appropriate and efficient manner. With increased reliance on the states in recent years in administering Federal funds, we believe that states, like universities, are capable of administering the SBDC Program without the addition of new regulatory requirements.

SBA should recognize that micro-managing SBDCs is not good management as it leads to the inefficient and ineffective operation of programs. This example should be struck from the regulation.

In addition, a sign-off procedure is now in use and SBA gives no justification for reversing this current practice.

129.15 (c) Disputes:(2) (iii): The establishment of a Cooperative Agreement Disputes Resolution Committee composed solely of representatives from SBA ignores the partnership nature of the program. We recommend the establishment of a balanced Committee, which includes non-SBA representatives.

(2) (B) There is no provision stipulating what happens if a written decision is not made in 45 days. This subsection should be rewritten to provide that if a decision is not made in forty-five days, the SBDC's position is automatically upheld otherwise an issue could remain unresolved indefinitely.

129.16 Suspension and Termination of the Cooperative Agreement

Attachment "L" to OMB Circulars 102 and 110 prescribes uniform suspension and termination procedures for Cooperative Agreements. There is no reason for SBA to impose additional detailed requirements on SBDCs.

129.16 (b) Suspension: This subsection makes it possible to close down an SBDC operation before the final disposition of a termination for cause proceeding. This is a one-sided, arbitrary and capricious process and it should be deleted.

129.16 (c) Causes for termination: This section adds further confusion. Examples of wording which are ambiguous and troubling abound. For example

(1) "willful or material failure"; without illustrative examples these words lend themselves to unchecked bureaucratic mischief and abuse.

(2) "indicating a lack of business integrity or honesty". Again, what is meant? To describe this language as overly broad is an understatement.

(3) "conviction of or civil judgment against the SBDC Director, any subcenter Director or any key SBDC employee..." It is unclear why a program should be shut down because of a single individual's misconduct, nor is it clear what a "civil judgment" encompasses. Does a divorce decree or a finding against an SBDC employee in a tort action give cause for shutting down an SBDC? This terminology is therefore too broad to be used as a cause for termination.

(4) Choosing two examples of conflict of interest in subsections 4(i) and 4(ii) also raises more questions than it answers. The conflict of interest issue should either be left open to local determination or a comprehensive conflict of interest policy should be established.

(4)(i) An SBDC should be prohibited from serving only those small companies in which the SBDC, any subcenter or any SBDC employee has a controlling financial interest. This prohibition should not be applied to a minority financial interest.

(6) This language should be deleted as many subcenter directors are not full-time. The size of many of the SBDC programs and the current level of Federal funding makes it impossible for each subcenter to have a full-time director. As stated earlier, full-time subcenter directors is not a requirement of law and therefore this provision can only serve to deny needed services to small businesses as existing subcenters will have to be closed.

129.16 (d) Procedures: (2) Cure notice (i): This section is permissive and therefore is of no benefit to the management of an SBDC. It says that the Deputy Associate Administrator for Business Development/SBDCs "may request" the Grants Management Branch Chief to send a cure notice. It is absolutely essential that this language be amended to require that a cure notice be sent as the next section addresses the termination of the Cooperative Agreement if the SBDC does not respond to such a cure notice. Subsection (ii) provides that SBA may terminate the Cooperative Agreement for "convenience" or can initiate termination for cause proceedings. It would seem that if the option is available to terminate for convenience, there would be no incentive to initiate the "termination for cause" proceedings which would be more time consuming for the agency. Therefore, reference to termination for "convenience" should be deleted.

(6) Notice of decision: (iv) The Cooperative Agreement can be terminated as stated in subsection (6)(iii), but SBA cannot require termination of an SBDC per se. Instead, SBA may merely terminate Federal funding of that particular SBDC Program.

129.16 (f) Effect of termination: (1) Again, SBA can discontinue Federal funding, but the agency cannot legally require activities not funded by SBA to be discontinued.

129.17 Small Business Development Centers (SBDCs)

This entire section should be deleted as the composition and management of an SBDC does not lend itself to the rigidity of regulation. These matters already are thoroughly and adequately addressed by statute and in SBA's annual Program Announcement.

129.17 (a) Area of Service and Location of SBDCs: (1) As a matter of policy, this section should not permit the establishment of more than one SBDC in a single state except those states -- New York, California, and Texas -- where multiple SBDCs have been previously contemplated and identified in response to Congressional inquiries.

(ii) This language violates the statutory language of P.L. 98-395 and the partnership aspect of the program. The statewide plan, as approved by SBA, is to determine the area to be served.

(3) "Satellites" are not specifically covered in Cooperative Agreements. This proposal will cause needless bureaucratic delay and is not in the interest of the small business community.

129.17 (b) Staff and access requirements: This entire subsection does not belong in regulation as it either restates language in the statute or Program Announcement. In addition, sections (b)(7), (b)(8), and (b)(9) are in conflict with OMB Circulars as they relate to salary charge methods and overhead and fringe allowances which are based on pools agreed upon by cognizant agencies, and which recognize vacations, holidays, retirement benefits, sick days, and so forth, as part of the negotiated rate. Section (b)(7) also is highly irregular as these assurances are all part of the time and effort reports required by the OMB Circulars. In subsection (b)(8) financial resources of virtually all SBDCs are insufficient for operating full-time satellites.

129.17 (c) Resources: (3) How are such programs to be "kept separate in funding, recordkeeping and client awareness." What does "client awareness" mean?

4(iii) The sentence beginning "The SBDC Director must ensure..." should be deleted. It is inconsistent with Section (c)(3). Further, it is impossible for the SBDC Director to play policeman and provide the guarantee SBA seeks. The SBDC Director should endeavor to make certain SBDC services do not duplicate other services.

129.17 (d) Services: (1) The language should be revised to direct the SBDC to endeavor not to duplicate or replace existing services. It is impossible for an SBDC to provide an absolute guarantee that its services are not being replicated somewhere in the state.

(4)(ii)(A) As worded, this subsection could create an unworkable situation and destroy the flexibility of the SBDC to respond to needs as they are identified and to take advantage of opportunities to cosponsor training with other groups or entities. It should be eliminated, or at the very minimum, be changed to permit SBA to make suggestions in developing SBDC training programs, but it should not be mandatory that all training be jointly planned.

(4)(ii)(B) The word "prominently" should be defined or deleted.

(4)(vi)(B) The word "comprehensive" should be defined or deleted.

(5) To require SBDCs currently at their funding cap to "upgrade and modify" is unacceptable as funding obviously does not permit this.

129.17 (e) Research: A requirement that no research shall be undertaken unless a review is made of "SBDC national research projects" is impossible to implement. It is also impossible to project eighteen months in advance research projects needed by the small businesses to be served and to project what projects will be undertaken. Further, neither the term "research" nor the phrase "SBDC national research projects" is defined. Even if "national research projects" were defined, how is an SBDC to become aware of such projects so that the SBDC may undertake the required review? Finally, some states, Iowa for example, require SBDCs to do research. The Federal partner should not prohibit SBDC research required by the state partner.

129.18 SBDC Clients

This section violates the partnership aspect of the program in that it gives SBA's Central Office and regional and district offices unilateral authority to set priorities for the "method and the delivery of assistance to SBDC clients" regardless of whether such needs correspond to those of the local small business community, the state and local governments and the SBDC host institution or agency. SBDCs are also required to provide assistance to "target groups" even though there may not be sufficient resources to adequately service both the targetted groups and eligible clients who independently become aware of possible SBDC assistance.

129.18 (a) Eligibility: The SBDC Program was designed to not only help individual small businesses, but there is a statutory mandate to work with other entities in assisting smaller firms with such matters as technology transfer, state and Federal regulatory compliance, and problem solving in the financial, marketing, personnel, manufacturing and other areas " needed by small business for growth and expansion, innovation, increased productivity and management improvement..." Thus, a requirement that only small businesses as defined by the Small Business Act receive assistance is inconsistent with the statute as such assistance may be rendered to other governmental or non-profit organizations whose principal mission is to help the small business sector. If this stipulation were to be adopted, it would force the dismantling of a significant portion of many SBDC operations which leverage their resources by working with such groups and organizations.

This section also fails to recognize that SBDCs for ten years have developed guidelines and exercised good judgment in determining whether an individual firm is a small business. To impose a strict size eligibility test would require the SBDC to cope with extremely complicated size standards which have given rise to numerous interpretative controversies. SBA has created a unit that does nothing but try to interpret and apply these size standards to specific situations. The process is extremely cumbersome and time consuming. We strongly recommend that SBA not subject the SBDC Program to this adminstrative quagmire.

129.18 (b) Priorities of assistance delivery: This section violates the concept of a partnership under Cooperative Agreements. The Program was not designed to simply carry out the mandates of the SBA; it was established to serve the small business community within each state. SBA again flaunts Congressional intent by arbitrarily placing itself in control and giving the Central Office authority to "set national priorities for the method and delivery of assistance to SBDC clients generally and for individual SBDCs through the annual Program Announcement and other issuances of the Central Office." (Emphasis added.) For the same reasons, the "region" -- presumably SBA regional offices -- and the district offices, should not be allowed to dictate priorities. The Cooperative Agreement signed by SBA and each SBDC means that this Program is a partnership with neither party dictating terms to the other.

129.19 Advisory Boards

There is no justification nor need for Advisory Boards to be covered by a Federal regulation.

129.19 (b) State/Regional SBDC Advisory Boards: (2) It is inappropriate to suggest that SCORE, ACE and/or SBI representatives serve on an Advisory Board. Board membership should be comprised of those qualified persons who are best suited to advise, counsel, and assist in the growth and development of the SBDC Program. Again, each state has its own unique needs which do not lend themselves to conformity with nationally dictated standards. Also, there should be a provision to allow SBDCs to use existing state small business advisory boards whose compositions have already been determined according to the unique needs of each state.

129.20 Financial Aspects Of The Program

Financial aspects of Cooperative Agreements are covered in the appropriate OMB Circulars. The Association finds no justification for departing from those Circulars. Further, the agency should develop and live by its own timetables. We strongly object to the inclusion of this section in any regulation.

129.20 (a) Budgeting: (1) Budget Proposal: (i-ii) Both subsections should be eliminated as they are a regurgitation of a proposal submission process which works only marginally now. To make this process part of the regulation would prevent its further refinement and make it impossible to develop a system which would be most appropriate for the SBDC Program. The system described and mandated herein was developed when the SBDC Program was much smaller and less mature than it is today. It is thus inappropriate to specify the process in regulation and it is particularly offensive to codify dates and time periods which the agency cannot now meet and which currently are in urgent need of revision.

(iii) The issuance of a letter by the Office of Procurement and Grants Management advising that funding will be continued should not be permissive, but should be mandatory. The word "may" should therefore be changed to "shall." Such a required letter should be received by the SBDC at least 30 days (not the stipulated two weeks) prior to the close of the current budget period. An SBDC cannot commit its own matching resources for the next operating period without timely assurance of continued Federal funding. This is but another example of SBA's one-sided approach to the partnership nature of the SBDC Program in that it assumes continued state funding of an SBDC in the absence of Federal match funds.

(iv) A letter of continuation should be issued (change "may to "shall") when refunding of an SBDC is anticipated. Again, the issue should be unequivocally resolved by requiring written notice. The stipulation that the letter shall lapse within 120 days should be deleted since delays which exceed 120 days have frequently occurred in the past, and if there is a conflict or a dispute procedure underway, funding should continue until the issue is finally resolved. More specifically, section (iii) and this section are unique to SBA. It is very risky for both SBA and the recipient institution to agree to accept a letter of continuation with no formal agreement in place. For example, the absence of a formal agreement means no provision is provided for an SBDC to undertake normal business operations such as invoicing or hiring for new positions. It is ironic that SBA includes those procedures now in place in the proposed regulation, yet publically admits its inability to produce Notice of Awards on a timely basis.

129.20 General Requirements: (A)-(C): These subsections cover operational items already addressed in each year's Program Announcement. They should be deleted from the regulation.

(D) This subsection is without legal precedent or basis. It is contrary to the statute establishing SBDCs and is inconsistent with requirements of OMB Circulars A-21 and A-87. Wnere, for example, costs of membership in professional associations would be allowable under the applicable Circulars for educational institutions and state or local governmental agencies the proposed regulation would impose serious limitations. Material departures from established government policies can only be construed as an effort to hamper the legitimate activities of institutions participating in the SBDC Program. One of the critical roles SBDCs must perform is to work closely with small business organizations. This Congressional mandate cannot be realized with arbitrary limitations of this kind. SBA should avoid discriminating against SBDCs by incorporating by reference a simple and accepted policy on associations dues. As stated in OMB Circular A-21: Costs of the institution's memberhip is civic, business, technical, and professional organizations are allowable.

129.20 (a)(c) Transfer of Funds. The applicable OMB Circulars provide maximums relating to out-fo-state travel and capital equipment without agency approval. There is no reason for SBA to be more restrictive.

(4) Carryover of Funds: (iv) This subsection does not address carrying forward unobligated, unexpended Federal funds, which is allowable under subsection (i) of this subsection (4). Such carryover funds would first have to be rolled over into the following year's award and into the letter of credit before the unexpended, Federal dollars are deducted. What

is meant by the use of the word "undigested" Federal dollars? The term should be either defined or deleted.

129.20 (b) Receipts: (1) Grants--Amount of Grant. (ii) The reference to $65,000,000 should be removed and replaced with the words "pro rata share of the formula in the law." The $65,000,000 amount may be changed and therefore should not be referenced in the regulations.

The entire section under (b) Receipts-(1) Grants--Amount of Grant and (2) Matching funds (i)-(ii) is a complete repetition of the statute. It is therefore unnecessary to reiterate all this information in the proposed regulation.

(iii) This subsection is in disagreement with the cash match definitional statement already prepared and distributed by SBA (SBA Notice 6000-122 effective October 11, 1986) and therefore should be made to conform to that notice. Further, the language must be changed to reflect the appropriation process in many states. Specifically, the last sentence should read "...must verify that such funds have been appropriated prior to expenditure of funds in the Cooperative Agreement."

129.20 (b)(v)(A) Restrictions in Overmatched Amounts. Although SBDCs are encouraged to furnish overmatch in this subsection, such amounts become part of the SBDC's Program budget for that year. Such a restriction provides a major disincentive for reporting overmatch because it makes those state resources subject to SBA control. Those state resources are outside the purview and scope of SBA's authority.

(v)(C) This section seems to be an unnecessary statement when section (a)(4)(ii) already states that "an SBDC may carry over unobligated, unexpended matching funds from one budget period to the next..." The ability to carry over unspent overmatch also is addressed in section (b)(2)(v)(B). However, the second part of (C) states that "verified unspent overmatched dollars may be used as a credit to offset an audit disallowance..." (Emphasis added). It should be allowable to use verified spent overmatch to offset confirmed audit disallowances applicable to the budget period in which the overmatch existed.

(vi)(A)-(E): Impermissible Sources of Matching Contributions. This list of impermissible sources of matching contributions should be deleted and replaced by referencing the appropriate sections in OMB Circulars. This is an arbitrary list which is neither complete nor accurate and creates even more confusion in the already confusing area of matching contributions. Part (E) is particularly difficult to interpret as this section has expanded on what is in both the statute and OMB Circulars. The reference to the inability to use "SBA supported companies or corporations..." is not acceptable since it is unknown who these companies or corporations are.

129.20 (b)(4) Program Income: (i)-(iv) This entire section should be deleted and replaced by referencing OMB Circulars. Subsection (ii) of part (4) already addresses the appropriate OMB Circulars and states that SBDC program income is subject to the provisions contained in these Circulars.

129.20 (b)(5) Fees: This section should be deleted. Charging fees for counseling services raises a host of other issues which create problems for the SBDCs and, most importantly, their small business clients. There has been no analysis of what the impact of charging fees would be either programmatically, administratively, or economically on either small businesses or the SBDCs; thus, it is inappropriate to address this issue at this time in a Federal regulation.

Further, this section conflicts with Congressional intent. Senate Report 98-309 states with respect to SBDCs charging fees for counseling:

> "However, the Committee would be concerned with any general policy of charging small business concerns a fee for one-on-one counseling. Such a fee structure could tend to increase the likelihood of direct competition between the SBDC and the for-profit sector."

SBDCs have attempted to avoid competing with the private sector as they strongly believe it to be an inappropriate role for government. The Association is surprised SBA would condone such competition with commercial providers of services. In doing so, SBA is repudiating a top recommendation (No. 3 overall) of the White House Conference on Small Business.

129.20 (c) Expenses: The applicable OMB Circulars (A-21 and A-87) establishing cost principles should apply. No further requirements by SBA are warranted. Each specific element of cost should be allowed or disallowed under generally applicable government policies contained in the relevant OMB Circulars. Substantial deviations from established Federal practices and policies contained in this section relating to salaries, travel, dues, and lobbying can only be described as arbitrary and legally questionable.

129.21 Evaluation of SBDC Program

The subject of the SBDC program evaluation is not appropriate for regulation. An evaluation process should be dynamic and fluid so it responds to the needs of the program and the small business community. As the SBDC network expands and changes, the evaluation procedures should also change. The evaluation processes outlined in this section have evolved over many years and should not, at this point, be committed to Federal regulation. As forms change and the Management Information System matures, evaluation needs and requirements will undergo further discussion and refinement.

129.21 (b) Client control records: This is an area which should be governed by policy and Program Announcements and not regulation. The types of records needed will vary and will be subject to change as the SBDC Program continues to mature.

(b) (6) Under no circumstances should records of SBDC clients who are also SBA clients be made available for duplication by SBA personnel. All information disclosed by a small business concern to an SBDC is done on the basis that such information will be held in absolute confidence and not disclosed to any other person other than an SBDC staff member or individual having an agency relationship with the SBDC, and then only in instances where access to sensitive company information is needed so appropriate services or advice and counsel can be provided to the client. Allowing SBA to have access to such records breaches the trust placed in the SBDC by not only that particular small business, but all existing and prospective clients as they rightfully can no longer assume that confidential and proprietary information will not be disclosed. This perception will seriously undermine the effectiveness of the SBDC because it is essential that it have access to such information if it is to be of genuine assistance.

129.21 (c) Performance reports: This subsection is also not appropriate for regulation. What each SBDC must provide in performance reports will depend a great deal on how the SBDC Program evolves. This can be fully covered each year in a more dynamic document such as the annual Program Announcement. A perfect example of the problem of putting this information in regulations is demonstrated in subsection (c)(2)(i) since this subsection refers to short-term and in-depth counseling, a distinction which recently has been removed by SBA. (SBA notice 600-137 effective October 23, 1986.)

129.21 (e) Audits and investigations: (1) General-(i) Access. Before enumerating the records (A-G) that should be available for examination in an audit, in parentheses it says the list is "subject to OMB approval." It is unclear how this affects the proposed regulation. For example, does OMB still have to give additional approval or is the list binding?

(2) Audits: (iii). This subsection is contradictory and it is unclear when the audits will take place. The subsection addresses the single audit of a recipient organization pursuant to OMB Circulars A-102 and A-110. Such single audits are supposedly a requirement and not an option; therefore, the SBDC Program should be audited according to the single audit procedure and not according to what is outlined in this proposed regulation. It is even more contradictory to have an agreement subject to the administrative constraints of a particular OMB Circular, A-110, which mandates its own audits, and then have SBA mandate a separate audit. A Cooperative Agreement falls under A-110 and its audit requirements and those requirements and results are sufficient. In section (iii) who would be financially responsible for such an audit? No funds are budgeted to enable an SBDC to go back several years and perform an audit. This section should be clarified or deleted.

(v) The implication is that annual audits will be required for all SBDCs that receive $200,000 or more in Federal funding. Since the statute requires all SBDCs to receive at least $200,000, section (v) is not consistent with section (iii).

(3) Investigations: It is unclear how SBA can determine when a person is "about to engage in an act or practice which would constitute a violation of the Small Business Act." This statement should be deleted.

(f) On-site reviews: This entire on-site review section should be deleted as it is inappropriate for regulation. The on-site review process is dynamic and will only be stifled by the proposed regulation.

CONCLUSION

In summary, the Association of Small Business Development Centers believes that the proposed regulation would seriously interfere with the effective implementation of the SBDC Program and as a consequence hurts the small businesses the SBDC Program is intended to serve. It fails to reflect applicable federal law and their legislative intent; it abrogates the relationship between the Federal government and universities, the Federal government and the states, and the Federal government and the private sector which is well-established under existing OMB Circulars. The proposed regulation is internally inconsistent; it negates existing SBA policies and guidelines governing the SBDC Program which have been carefully negotiated and agreed to by SBA and the SBDCs; and, it violates fundamental principles of good program management which should encourage diversity, flexibility, innovation, decentralization and partnership. For each and all of the above reasons, we strongly urge that SBA withdraw this proposed regulation.

Respectfully,

G. Thomas Cator

G. Thomas Cator
Executive Director

Chairman LaFalce. Thank you very much. We are not going to get into the questions right now. But for those of you who have not appeared before me, one of the things that I always like to do is ask one witness, or all of the witnesses, if any other witnesses have said something that they disagree with. And I can see that Mr. Carroll would have disagreed with Mr. Purdy on the subject of SBDC's, and we will want to give you a little bit of an opportunity for dialogue and debate. We will get to that.

Our next witness will be Mr. Randy Croxton. Mr. Croxton.

TESTIMONY OF RANDY CROXTON, VICE PRESIDENT, BALTIMORE ECONOMIC DEVELOPMENT CORP., REPRESENTING NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES, WASHINGTON, DC

Mr. Croxton. Thank you, Mr. Chairman. Good morning to you. I am Randy Croxton, vice president of the Baltimore Economic Development Corp., and the Region III director for the National Association of Development Companies. NADCO represents certified development companies that lend money to small businesses under the SBA 503/504 loan program, which provides long-term, fixed-asset financing to qualified small businesses for expansion, job creation, and economic development.

Since 1981, CDC's have issued more than $800 million in debentures which, in turn, has leveraged well over $1 billion in private capital to create more than 100,000 jobs at an average Federal investment of $7,400 per job. Defaults under this program are running at a rate of less than 3 percent.

I would like to thank you for the opportunity to appear before this committee today to discuss NADCO's legislative priorities for the 100th Congress.

We have identified five issues of particular concern that we would like to see addressed by this committee. Before getting into these issues, I would like to briefly give you some background on the newly implemented program of selling development company debentures to private investors.

SBA 503 debentures approved prior to July 1, 1986 were funded through the Federal Financing Bank at an interest rate equal to the comparable Treasury rate plus one-eighth of a point administrative fee. However, a change in this funding procedure was mandated by the Combined Omnibus Budget and Reconciliation Act of 1986, which was signed into law last April.

The Act requires that debentures be sold to private investors rather than to the Federal Financing Bank. The result is that privately sold development company loans are scored as guaranteed loans instead of direct loans in the SBA budget at a considerable savings.

The first sale of 504 debentures took place last November. Sales of 20-year debentures have continued monthly since then. Ten-year debentures are sold quarterly due to lower volume. Twenty-year debentures sold in February carry an interest rate of 8.40 percent. The rate to the borrower after the servicing fees are added is approximately 9 percent, fixed for 20 years. This leads me into our first legislative priority, the fiscal year 1987 budget authority.

Congress initially authorized the private sale of development company debentures on a pilot program basis. Because the private sale process had not yet been developed, authority for the program was split for fiscal years 1986 and 1987 between the Federal Financing Bank and the private market.

Now that the private sale program has been implemented successfully, $155 million of authority allocated to the Federal Financing Bank for the current fiscal year may not be available for sale in the private market unless Congress acts to correct the situation.

This committee has indicated that it intends to make permanent the pilot program of private sale of development company debentures. NADCO concurs with this decision. The budgetary impact of a 503 program of sale to FFB that is scored dollar for dollar will preclude Congress from appropriating sufficient levels of authority to meet the program's demand.

The switch to private sales solves that problem. Given that fact, however, attempting to revert to the 503 procedures would be an administrative nightmare. More importantly, it would be very destructive to the ongoing 504 program. An interruption of the flow of debentures into the market would raise questions in the minds of investors which would likely translate to higher interest rates for future 504 borrowers.

It would also create the inequitable situation in which 503 borrowers would receive interest rates more than a full percent lower than other, similarly qualified 504 borrowers.

At the current rate of activity, private sale authority will be depleted sometime in the third quarter of this fiscal year. We request that the committee take action before that time to assure that small business borrowers will have access to the full amount of assistance that Congress intended through the development company program, while saving the Federal Government a considerable amount of budget expenditure.

Our second issue of concern is the fiscal year 1988 SBA budget. In developing SBA's budget for fiscal 1988, we ask that the committee maintain a funding level for the development company loan program of at least the current $373 million and preferably higher to ensure that funds are available to meet the small business demand for these loans.

Authority this year is running just about at the level of demand. In fact, demand outstripped authority at the end of the first quarter causing some borrowers to have to wait until second quarter money was available to get approval for their loans.

One aspect of the administration's budget which especially concerns us is the proposed imposition of additional fees on most SBA-guaranteed lending programs. We believe that fees are already pushing the limit of what borrowers can afford, and we would oppose such increases across the board.

This is particularly a problem in the 504 program, however, due to the significant increase in fees and in interest rate this program has absorbed as a result of leaving the Federal Financing Bank. The cost to borrowers of this change is well over 1 percent added into the interest rate of their loans.

Also, an additional point up front has been added to cover the administrative costs of selling debentures in the private market, as well as a new, half of a 1-percent fee charged by SBA. A total of 3.25 points up front is currently charged to a borrower for obtaining 504 financing.

One other point we would like the committee to consider in this regard is the benefit accruing to the SBA in interest income under this program. The debentures that CDC's sell to fund 504 small business loans amortize semiannually, while the corresponding notes paid by the borrowers amortize monthly. The borrowers' monthly payments are sent to a master account owned by the SBA and maintained by the central servicing agent for the program.

When a semiannual payment on the debenture is due, the payment is taken from the master account out of the monthly payments made by the borrower. However, the interest earned on those monthly payments remains in the account and belongs to the SBA. Interest on a separate fee account similarly owned by the SBA and maintained by the central servicing agent also accrues to SBA's benefit.

Our next issue of concern is the prepayment of 503 loans. We are extremely concerned about the adverse impact on small business borrowers of current prepayment terms on SBA 503 debentures held by the Federal Financing Bank. I will not begin to try to explain the FFB's rationale for imposing these terms, or its formula for calculating the prepayment price, but I can tell you that the bottom line to the borrower can be more than 50 percent of the outstanding principal balance owed to prepay a 503 loan.

These severe premiums are the result of a significant drop in interest rates over the past five years. Borrowers obtaining financing in 1981, for example, may be holding loans with interest rates of as much as 15.5 percent. That was an attractive rate when prime was over 20 percent, but many borrowers are understandably upset at the prospect of being tied to this high rate when loans are currently being financed at something closer to 9-percent interest.

Senator Metzenbaum attempts to address the 503 prepayment problem in a bill he introduced on February 3 which has been referred to the Senate Small Business Committee. This legislation, S. 437, would preclude the FFB from imposing a premium on borrowers who wish to prepay their 503 loans. NADCO supports the concept of allowing 503 borrowers to prepay their existing loans with the FFB at par. However, we believe that this bill does not go far enough. Implementation in its current form would continue to disenfranchise those borrowers most in need of relief. Senator Metzenbaum's approach is only a solution to inordinately high interest rates for borrowers who are capable of obtaining conventional financing. The whole point of this guarantee program is to allow small businesses who cannot get conventional financing to expand, create jobs, and spur economic development in their communities. Only the most healthy, and least in need of a break from the Federal Government, will benefit from this legislation as it stands now.

Chairman LaFalce. Mr. Croxton, if I could interrupt you for a second for a statement from Mr. McDade.

Mr. McDade. Mr. Croxton, excuse me for interrupting your statement. I want to tell you and the panel that I have an Appropriations Committee meeting at 10 o'clock which I must attend, so I do have to leave. A lot of people who do the work that you have done sometimes do not understand the full congressional demands of time and being at two places at one time. That happens to us all the time.

And I do want to assure you that is the reason I wanted to interrupt you at this juncture because I must leave. I want to assure you that we are very, very interested in all of your comments. We will be hearing from both sides. I want to congratulate you for the testimony that I have been able to hear. And I regret that I cannot hear you, Mr. Thomas, and I guess Ms. Stevens that you are also going to testify.

But members on my side of the aisle will be here, and the committee will be sifting through both your agreements and disagreements, as the chairman has pointed out, and working together with you to try to reach solutions on a good program for the fiscal year. Thank you very much. Thank you, Mr. Chairman.

Chairman LaFalce. Thank you. Please continue, Mr. Croxton.

Mr. Croxton. OK; thank you. I was saying that only the most healthy firms will benefit from this legislation as it now stands, because only they will be able to replace their 503 loans with conventional loans at lower rates.

We would recommend that Congress go one step further to better serve the needs of those it intended to assist in the first place. By allowing 503 borrowers to refinance their loans through the 504 private sale process at substantially lower rates, Congress would indeed assist those borrowers. At the same time, it would reduce the Federal Government's contingent liability and have the effect of selling the 503 asset at par, presumably resulting in a budgetary savings. Obviously, details of such a plan would have to be carefully worked out, but we believe that it is workable, and would benefit the borrowers and the Federal Government.

The fourth issue of concern is the sale of 503 assets. Should the committee choose not to pursue the possibility of refinancing the 503 portfolio, that portfolio may well be a candidate for a more traditional asset sale. NADCO is interested in participating in any discussion concerning the possible sale of 503 assets. If the 503 portfolio were to be sold without recourse, we would propose that the certified development companies be given first option to repurchase their own debentures. This would protect the small business borrower from unusually harsh collection or liquidation procedures that might be taken by a private investor without any personal interest in the borrowers and over whom SBA has no regulatory authority.

If Congress pursues a sale with recourse, we recommend that the procedures for selling 504 debentures already in place be utilized in selling 503 debentures. A marketing and underwriting process has already been established consisting of parties who are familiar with the program and the security.

The last issue that I would like to address is the ceiling on the 504 assistance to a borrower. Currently, there is a $500,000 ceiling on the amount of SBA guaranteed financing available to any single borrower under the 504 program. NADCO recommends increasing that ceiling to $1 million per borrower.

We would request this for the following reasons. First, market pressures brought on at least in part by the declining availability of industrial development bonds and industrial revenue bonds has increased the demand for long term financing on projects in the $1.5 million to $2.5 million range. We currently are unable to make a significant contribution to projects of this size.

Second, the natural impact of inflation has the effect of limiting our ability to assist legitimate economic development projects of firms that fall well within the SBA's requirements to be considered a small business.

Third, because the program has a requirement that one job be created per every $15,000 of 504 debenture, an increase in the ceiling would not compromise the job creation and community impact aspect of the program. In fact, the job creation impact is often much greater for larger projects.

In conclusion, the issues that I have discussed have been identified by NADCO's board of directors and members as priorities for the current legislative session. We appreciate the opportunity to appear before you today, and look forward to working with the committee in the coming months on these various issues. Mr. Chairman, this concludes my prepared remarks.

[Mr. Croxton's prepared statement follows:]

PREPARED STATEMENT OF RANDY CROXTON, VICE PRESIDENT, BALTIMORE ECONOMIC DEVELOPMENT CORP., REPRESENTATING NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES, WASHINGTON, DC

Good morning. I am Randy Croxton, vice president of the Baltimore Economic Development Corporation, and Region III Director for the National Association of Development Companies, representing certified development companies that lend money to small businesses under the SBA 503/504 loan program. I want to thank you for the opportunity to appear before this Committee today to discuss NADCO's legislative priorities for the 100th Congress.

We have identified five issues of particular concern that we would like to see addressed by this Committee.

1) Our first priority is assuring that a technical point in the FY 1987 appropriation for the development company program does not indavertently prevent the use of $155 million of the program's $373 million allocation. That $155 million, technically allocated to the 503 program for sale to FFB instead of to the 504 program for sale to private intestors at a considerable savings to the federal government, may be lost without congressional intervention. If approvals under 504 continue at the current rate, money for the program will be exhausted some time during the third quarter of this fiscal year.

2) Of course, projected funding levels for FY 1988 are a chief concern, as well as the threat of additional "user fees" such as those proposed in the Administration's FY 1988 budget.

3) Prepayment of 503 loans held by FFB is another priority for CDCs and especially for their borrowers. Under the terms of the 503 debenture which funds the small business loan, FFB imposes prepayment premiums of as much as 50 percent of the outstanding principal balance. Some of these loans carry interest rates as high as 15-1/2 percent. We would propose that Congress grant authority to refinance those loans, at substantially lower rates and at substantial savings to the federal government, through the privately-funded 504 process.

4) NADCO is also interested in participating in any discussion concerning the possible sale of 503 debentures currently held by FFB. If that portfolio were to be sold without recourse, we would recommend that CDCs be given the option to re-purchase their own debentures. This would protect the small business borrower from unusually harsh collection or liquidation procedures, and preserve the servicing system currently in place. If loans are to be sold with recourse, we would recommend coordination of those sales through the Development Company Funding Corporation, which acts as selling agent to CDCs in the 504 program. DCFC's coordination would assure an orderly marketing procedure that will not compete with 504 debenture sales and will benefit both asset sales and the 504 program.

5) Finally, we would like to initiate a discussion with the committee concerning raising the ceiling of $500,000 per borrower for 504 loans.

BACKGROUND

The Small Business Administration's 503 lending program was established in 1980 by section 503 of the Small Business Investment Act to provide long-term, fixed-asset financing to qualified small businesses through local development companies certified by SBA. To qualify for assistance under the development company program, a small business must demonstrate that the financing will have a significant economic impact in its community, usually through job creation.

The program is designed to work in conjunction with private sources of financing. Typically, a commercial lender provides 50 percent of the project cost in return for a first position lien on the property or machinery being financed. The CDC debenture, fully guaranteed by SBA, provides 40 percent and is secured by a second lien position. The remaining 10 percent equity is provided by the small business borrower.

Since its inception, the 503 program has issued more than $800 million in debentures, which in turn has leveraged well over $1 billion in private capital to create more than 100,000 job opportunities throughout the country, at an average federal investment of $7,400 per job.

PRIVATE SALE FUNDING

SBA 503 debentures approved prior to July 1, 1986 were funded through the Federal Financing Bank at an interest rate equal to the comparable Treasury rate plus one-eighth of a point administrative fee. However, a change in this funding procedure was mandated by the Combined Omnibus Budget and Reconciliation Act of 1986, which was signed into law April 7, 1986.

The Act requires that debentures be sold to private investors rather than to FFB. This change was intended to preserve adequate funding levels for the program while significantly reducing the program's cost in terms of SBA budget authority. The result under current budget accounting is that privately sold development company loans are scored as guaranteed loans instead of direct loans in the SBA budget.

In designing the system for private sale of debentures, every attempt has been made to make the transition as orderly as possible. With few exceptions, credit and other requirements and procedures for borrowers, CDCs and SBA have been preserved. SBA's considerable efforts to comply with very strict deadlines for implementation mandated by the law made the transition to the private market possible without a break in CDCs' ability to offer lending assistance to qualified small businesses. We are extremely appreciative of their work.

On July 1, 1986 the SBA began guaranteeing development company debentures for funding in the private capital market. These debentures are known as "504 debentures" to distinguish them from "503 debentures," which are sold to FFB. SBA-guaranteed 504 debentures are sold through the Development Company Funding Corporation (SBA-appointed Selling Agent for CDCs) to underwriters, who pool them and offer certificates representing interests in the pool to investors.

The first sale of 504 debentures took place in November, 1986. Sales of 20-year debentures have continued monthly since then and 10-year debentures, which have a lower volume, are being sold quarterly.

The debentures currently carry a fixed interest rate of approximately 115 basis points higher than Treasury yields over securities of comparable maturities. Since the debentures are amortized with periodic payments of principle and interest in much the same manner as a home mortgage, they are estimated to have an average life of about one-half of their stated maturity. Therefore, we use the Treasury 5-year and 10-year rates as a basis for determining the 10-year and 20-year debenture rates, respectively.

For example, 20-year debentures sold in February 1987 carry an interest rate of 8.40 percent; 115 basis points above the 7.25 percent 10-year Treasury rate. The effective rate to the borrower after servicing fees are added is approximately 9.0 percent.

Additional frontend fees to the borrower associated with private sale of 504 debentures are as follows: a fee to the underwriters of approximately 5/8 of one percent and a funding fee of 3/8 of one percent to cover printing, legal and DCFC expenses. The two percent reserve account in the 503 program (which belonged to the borrower) has been replaced with a non-refundable 1/2 percent fee paid to SBA. Servicing fees to the CDC (1-1/2 percent) and the Central Servicing

Agent (1/4 percent) remain unchanged from the 503 program. Total front-end fees in the sale of a 504 debenture add up to 3-1/4 points.

More than $200 million in small business assistance has been approved by SBA through this private-sale program since it began last July. Of those approvals, more than $40 million has actually been funded.

I. FY1987 BUDGET AUTHORITY

Congress initially authorized the private sale of development company debentures on a pilot program basis. In FY1986, $200 million of the $387 million development company program appropriation was targeted for sale to FFB, with the balance for private sale to investors. This allowed SBA and the development company industry time in that fiscal year to use FFB authority, while developing and implementing a process for the private sale.

As a precaution in that FY1986 budget, Congress allocated $155 million of the FY1987 program authority for sale to FFB. If the private-sale program were not a success, there would at least be some money for the program available in the next fiscal year. If the pilot program were successful, Congress would have the opportunity to move the entire FY1987 authority into the private-sale program as part of the FY1987 budget process. In fact, language to do so was to be included in the FY1987 budget conference report. However, issues unrelated to this program prevented the House and Senate from issuing a conference report on the SBA budget, so the adjustment was never made.

Initially, using that authority to tap back into the substantially lower rates available through the 503/FFB program seems very attractive. However, after careful consideration, we believe that such a move would not be in the long-term best interests of the program. This Committee has indicated that it intends to make permanent the pilot program of private sale. NADCO concurs with this decision. The budgetary impact of a 503 program that is scored dollar-for-dollar would preclude Congress from appropriating sufficient levels of authority to meet the program's demand. The switch to private sales solves that problem.

Given that fact, however, attempting to revert to 503 program procedures to use the $155 million would be an administrative nightmare. More importantly, it would be very destructive to the ongoing 504 program. An interruption of the flow of debentures into the market would raise questions in the minds of investors which would likely translate into higher interest rates for future 504 borrowers. It would also create the inequitable situation in which borrowers receiving 503 loans would have the benefit of interest rates more than a full percent lower than other, similarly qualified borrowers receiving 504 loans.

Finally, transferring authority from FFB to the private sale program would save the federal government a considerable amount of budget expenditure. Loans sold to private investors only cost the government in the event of default. Loans sold to FFB are dollar-for-dollar outlays that must be included in SBA's budget.

At the current rate of activity, private-sale authority will be depleted some time in the third quarter of this fiscal year. We request that the Committee take action before that time to assure that small business borrowers will have access to the full amount of assistance Congress intended through the development company program.

II. FY 1988 SBA BUDGET

We ask that the Committee maintain a funding level for the development company loan program of at least $373 million in FY 1988 to ensure that funds are available to meet the small business demand for these loans. Current authority is running just about at the level of demand. In fact, demand outstripped authority at the end of the first quarter of this year, causing some borrowers to have to wait until second quarter money was available to get approval for their loans. Further, as tax-exempt bonds and other traditional means of economic development financing become more scarce, we believe demand for this program will increase. Its track record and low default rate (under three percent) make it an effective use of limited government funds.

One aspect of the Administration's budget that especially concerns us is the proposed imposition of additional fees on most SBA guaranteed lending programs. We believe that fees are already pushing the limit of what borrowers can afford when trying to secure financing, and would oppose such increases across the board.

This is particularly a problem in the 504 program, however, due to the significant increase in fees and in interest rate this program has absorbed as a result of leaving FFB. The cost to borrowers of this change is well over one percent added into the interest rate of their loans. Also, an additional point up front has been added to cover the administrative costs of selling debentures in the private market, as well as a new, one-half percent fee charged by SBA. A total of 3-1/4 points up front is currently charged to a borrower for his or her 504 financing.

One other point we would like the Committee to consider in this regard is the benefit accruing to the SBA in interest income under this program. The debentures that CDCs sell to fund 504 small business loans amortize semiannually, while the corresponding notes paid by the borrowers amortize monthly. The borrowers' monthly payments are sent to a master account owned by SBA and maintained by the central servicing agent for the program. When a semiannual payment on the debenture is due, the payment is taken from that master account out of the monthly payments made by the borrower. However, the interest earned on those monthly payments remains in the account and belongs to SBA. Interest on a separate fee account similarly owned by the SBA and maintained by the central servicing agent also accrues to SBA's benefit. We do not have exact dollar amounts to present to you today, but we are working on projecting the benefit to the agency, and translating that dollar benefit into an up-front fee equivalency. We will make this information available to the Committee, and hope that you will take this very real contribution by the borrowers to the SBA into account when considering the issue of additional fees.

III. PREPAYMENT OF 503 LOANS

We are extremely concerned about the adverse impact on small business borrowers of current prepayment terms on SBA 503 debentures held by the FFB. These terms, established by FFB and imposed even on SBA if it must purchase a debenture in the event of default, provide for a premium or discount based on the relationship between interest rates when the loan was made and current rates at the time of prepayment. I will not begin to try to explain FFB's rationale for imposing these terms, or its formula for calculating the prepayment price, but I can tell you that the bottom line to the borrower can be more than 50 percent of the outstanding principal balance owed. What's more, FFB charges the borrower a $1,000, non-refundable deposit just to determine what it will cost to prepay.

These severe premiums are the result of a significant drop in interest rates over the past five years. Borrowers obtaining financing in 1981, for example, may be holding loans with interest rates of as much as 15-1/2 percent. That was an attractive rate when prime was over 20 percent, but many borrowers are understandably upset at the prospect of being tied to this high rate when loans are currently being financed at something closer to nine percent interest.

I might add here that this is only a problem in 503 loans sold to FFB, not in loans sold to investors under the 504 program. Because of our concern about the adverse effect of the 503 prepayment terms, the industry worked with SBA to design more reasonable and manageable prepayment terms for 504 borrowers. The 504 borrower is given a schedule at the time the loan is made detailing an exact dollar amount of prepayment premium, which declines ratably over the first half of the term of the loan. 504 borrowers may prepay at par at any time during the second half of the term of their loan.

Senator Metzenbaum (D-OH) attempts to address the 503 prepayment problem in a bill he introduced on February 3, 1987 which has been referred to this Committee. This legislation, S. 437, would preclude the FFB from imposing a premium on borrowers who wish to prepay their 503 loans. NADCO supports the concept of allowing 503 borrowers to prepay their existing loans with the FFB at par, and commends Sen. Metzenbaum for his efforts in championing 503 borrowers. However, we believe that this bill does not go far enough, and that implementation in its current form would continue to disenfranchise those borrowers most in need of relief. Sen. Metzenbaum's approach is only a solution to inordinately high interest rates for borrowers who are capable of obtaining conventional financing. The whole point of this guarantee program is to allow small businesses who cannot get conventional financing to expand, create jobs, and spur economic development in their communities. Only the most healthy (and least in need of a break from the federal government) will benefit from this legislation as it now stands, because only they will be able to replace their 503 loans with conventional loans at lower rates.

We would recommend that Congress go one step further to better serve the needs of those it intended to assist in the first place. By allowing 503 borrowers to refinance their loans through the 504 private sale process at substantially lower rates, Congress would indeed assist those borrowers. At the same time, it would reduce the federal government's contingent liability and have the effect of selling that 503 asset at par, presumably resulting in a budgetary savings. No new budget authority should be required, because the agency's liability has not changed as a result of the refinancing. Obviously, details of such a plan would have to be carefully worked out, but we believe it is workable, and would benefit the borrowers and the federal government. If this concept interests the Committee, we would welcome the opportunity to explore the matter further.

IV. SALE OF 503 ASSETS

Should the Committee choose not to pursue the possibility of refinancing the 503 portfolio, that portfolio may well be a candidate for a more traditional asset sale. NADCO is interested in participating in any discussion concerning the possible sale of 503 assets. In terms of logistics, some immediate questions come to mind:

o Would the sale be the responsibility of SBA or the FFB?

o If the SBA were to conduct the sale, how would the portfolio be transferred from FFB, and would that transfer require an appropriation?

o If an appropriation were needed, would it be for the outstanding principle balance of the loans being purchased, or for the prepayment price as calculated by FFB?

o How would such a sale be scored under each of the scenarios described above?

Obviously, these questions cannot be fully answered until a determination is made about whether to sell with or without the federal guarantee. If that portfolio were to be sold without recourse, we would propose that CDCs be given first option to purchase their portfolios. This would protect the small business borrower from unusually harsh collection or liquidation procedures that might be taken by a private investor without any personal interest in the borrowers and over whom SBA has no regulatory authority.

If Congress pursues a sale with recourse, we recommend that the procedures for selling 504 debentures already in place be utilized in selling 503 debentures. A marketing and underwriting process has already been established consisting of parties who are familiar with the program and the security. Also, by conducting the sale through the Development Company Funding Corporation (selling agent for CDCs in the 504 program), timing of the 503 asset sales can be coordinated to assure they do not compete with the ongoing monthly sales of 504 debentures and that the best price is achieved for the asset sales.

V. CEILING ON 504 ASSISTANCE TO A BORROWER

Currently, there is a $500,000 ceiling on the amount of SBA-guaruanteed financing available to any single borrower under the 504 program. NADCO recommends increasing that ceiling to $1 million per borrower. We make this request for the following reasons:

o Market pressures, brought on at least in part by the declining availability of IDBs and IRBs has increased the demand for long-term financing -- which is the main thrust of small business expansion -- of projects in the $1.5 - $2.5 million range. We currently are unable to make a significant contribution to projects of this size. Our normal participation of 40 percent of total project costs would be $600,000 to $1 million for these size deals.

o The natural impact of inflation since the program's inception in 1980 has had the effect of limiting our ability to assist legitimate economic development projects of firms that fall well within the SBA's requirements to be considered a "small business."

o Because the program has a requirement that one job be created per every $15,000 of 504 debenture, an increase in the ceiling would not compromise the job creation and community impact aspect of the program. In fact, the job-creation impact is often much greater for slightly larger projects.

VII. CONCLUSION

The issues outlined above have been identified by NADCO's Board of Directors and members as priorities for the current legislative session. We appreciate the opportunity to appear before you today, and look forward to working with the Committee in the coming months on these various issues.

Mr. Chairman, this concludes my prepared remarks. I would be happy to answer any questions you and the other Members of the Committee might have.

Chairman LaFalce. Thank you very much, Mr. Croxton. Your testimony was quite detailed and complex and deserving of great attention, which we will certainly give in the days and weeks ahead.

Our next witness will be the vice president of the American Surety Association, Ms. Elaine Stevens. Ms. Stevens.

TESTIMONY OF ELAINE STEVENS, VICE PRESIDENT, THE AMERICAN SURETY ASSOCIATION [TASA]

Ms. Stevens. Thank you, Mr. Chairman. I am Elaine Stevens, vice president of The American Surety Association. I am assistant vice president of Transamerica Premier Insurance Co., in Irvine, CA, and I manage the surety bond program. Transamerica Premier is the largest producer in the Small Business Administration's surety bond guarantee program. We issue bonds in 48 States, all States excluding New York and New Hampshire.

The association was organized in 1980. It unites over 150 surety companies, general agents, attorneys, and contractors. The primary task of the association since it was organized has been to ensure the continued availability of surety bonds for small and minority contractors.

I must say at the outset that reaching that goal has been and continues to be an uphill struggle. All of our members participate to a greater or lesser degree in the Small Business Administration's surety bond guarantee program. This program since its inception in the early 1970's has been instrumental in providing thousands of jobs in the construction industry and in providing a dependable vehicle for thousands of small and emerging contractors to obtain necessary bonding at reasonable rates.

Organizationally, the program is everything a Government program should be. It is based on guarantees, not loans. It is conducted for the most part by the private sector with Government participation limited to a relatively small staff nationally. I believe that the staff at present is somewhere between 50 and 55 employees.

In addition to receiving a direct cash return from the contractor, the Federal Government receives a substantial benefit in reduced construction costs resulting from the increased competition provided by small construction firms. In fact, a General Accounting Office study suggested that the competitive offset provided by the increased competition saves the Federal Government as well as State and local governments millions of dollars each year.

The total budgetary outlay for the program amounts to about $10 million, not a large sum in terms of the overall Federal budget. Despite the fact that the program provides a mechanism for essential bonds for new and emerging contractors, despite the fact that the program actually saves money, despite the fact that the program provides thousands of jobs in an industry that can employ workers with little experience and education, despite all of this, the budget for the program has been under constant attack. Some government executives completely ignore the fact that the program is specifically designed for high risk businesses, and that loss ratios should be slightly higher than those in the standard markets.

The American Surety Association has urged repeatedly, and is recommending now, that the guarantee authority for the surety bond guarantee program be set up as a revolving fund so that unused guarantee authority can be recycled and thus provide an increased bonding capability. Those opposed to this recommendation argue that recycling budget authority will increase actual budget expenditures, since every dollar of budget authority allocated produces a certain statistical loss in actual dollars.

I can accept this point of view, but must counter with the proven worth of the program in jobs and small business support and its relatively low cost. Even doubling the guarantee authority for the surety bond guarantee program would not increase actual expenditures to any significant level, but would provide a tremendous shot in the arm for small and emerging businesses in a highly volatile and critical industry.

Shutdowns have hurt the very contractors we are trying to help. In 1986, the program was out of funds and shut down for virtually the entire fiscal fourth quarter, which is the busiest time of the year in the construction industry. Many of our contractors, especially those in the northern States, rely on jobs that they get in September to carry them through the winter months. With our largest producing agent being based in Colorado, this has been a serious problem for us. We have seen the impact of this shutdown reflected on many of the contractor's yearend or interim financial statements which show little or no profit. Most of them managed to keep afloat, but barely. Another year of periodic bonding will surely see many of them go into liquidation.

The SBA wants to make this program self-supporting. They propose doing this by substantial fee increases from both the contractor and the surety. They also have recently implemented stringent underwriting requirements, the most costly to the contractor being the need to have audited financial statements for any job over $350,000. An audited financial statement can cost in excess of $10,000. We are increasing rates and tightening our underwriting in the face of a declining loss ratio. How can we justify these increases? If I tried to file a rate increase with any State insurance department when my losses were decreasing, I would have my filing declined by return mail. And yet this is exactly what the SBA is recommending.

In 1985 the conventional surety market had the worst year in it's history. This caused them to clean house and discontinue writing bonds for a large number of contractors. These contractors have only two markets open to them now, the highly collateralized market where they must pledge their homes and most of their assets, or the SBA program.

Thus, there is a greater need for the program than ever before. But we need to keep credibility as well; and we cannot do this with continuous shutdowns and constantly changing requirements. Thank you, Mr. Chairman.

Chairman LaFalce. Thank you very much, Ms. Stevens, for a very fine presentation.

Our next and last witness today will be Mr. Ralph Thomas, the executive director of the National Association of Minority Contractors.

TESTIMONY OF RALPH C. THOMAS III, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF MINORITY CONTRACTORS

Mr. THOMAS. My name is Ralph C. Thomas III, and I am the executive director of the National Association of Minority Contractors otherwise known as NAMC. NAMC is a nonprofit business trade association representing more than 3,500 minority construction firms across the country.

From the outset, I should state that I disagree with a couple of my colleagues here, and we are strongly opposed to the administration's proposal to transfer the Minority Business Development Agency otherwise known as MBDA from the Department of Commerce to the Small Business Administration. We are also concerned about other aspects of the budget proposal, but for now we would like to concentrate on the MBDA issue.

The MBDA is presently the only Federal Government component, or quasi-agency or sub-agency whose sole function is the promotion of minority business development. The SBA on the other hand has a much wider legislative mandate, and must sometimes take stands in the interests of small businesses which may not be in the best interest of minority business.

Moreover, MBDA's programs are designed to encourage the economic competitiveness of more than 700,000 minority firms in the general marketplace. The SBA's minority business programs focus almost entirely on set-asides from the Federal sector for the 15,000 or so companies presently admitted to the SBA set-aside program.

The NAMC also feels that as part of the Department of Commerce, MBDA has direct access to the mainstream of America's business community and cabinet level resources that facilitate assistance to minority entrepreneurs. Transferring the MBDA to the Small Business Administration could send an erroneous signal to the MBDA's constituency. Minority firms could interpret this to mean that this administration seeks to severely limit minority business participation in the American economy by demoting its status from an agency within a cabinet level department to an agency within another agency.

Most importantly, however, is the fact that MBDA, because of its organizational alignment within the U.S. Department of Commerce, has increased corporate America's support for minority business enterprise and their level of involvement in the development of minority owned firms. Because of MBDA's working relationship with various minority business trade associations, particularly the National Minority Supplier Development Council, corporate America did over $8 billion worth of business with minority entrepreneurs. Furthermore, the MBDA is not limited, as is the SBA, by size standards as to the types of minority businesses it can assist. Transferring the MBDA to the SBA to carry out its present mission could cause mass confusion for constituents on this point alone.

Finally, it should be noted that MBDA has provided a number of comprehensive assistance services to minority businesses, particularly through its nationwide network of Minority Business Development Centers, otherwise known as MBDC's, which provide management and technical assistance to MBE's, meaning minority business enterprises.

Having traveled to 25 States in just the past 12 months, I have personally found that MBDC's have often served as the focal point for local minority contractor associations to meet, network, and express their local concerns. Thus, NAMC feels that the minority business community would be better served by allowing MBDA to remain within the Department of Commerce.

As to some of the other proposals by the administration for the SBA, the NAMC also opposes cuts in SBA's 7(j) contracts as well as the elimination of SBA business development expenses and SBA direct loans. Minority entrepreneurialship is a significant key in combating the very serious problem of minority unemployment in America.

In 1981, The Center for Systems and Program Development, Inc. in Washington, DC, conducted a survey among minority owned firms in the Washington Metropolitan Area among which 8(a) firms are heavily represented. The survey indicated that employment among these minority businesses greatly exceeded the national averages. Estimated employment for the 250 firms represented by the sample showed a total of 14,234 employees. Many of these employees in professional, technical, and managerial categories would not find comparable positions in either the public or non-minority private sector if their jobs were terminated.

Since minority business development is so crucial to the well-being of the national economy, SBA assistance programs should be strengthened rather than reduced.

This concludes my testimony, Mr. Chairman. I am prepared to answer any questions you might have.

Chairman LaFalce. Thank you very much, Mr. Thomas. What I would like to do is defer my questions until the other members of the committee have an opportunity to ask theirs. And I will first call on Mr. Bilbray for his questions.

Mr. Bilbray. I do not have any questions, Mr. Chairman.

Chairman LaFalce. All right. Thank you very, very much. Mr. Lancaster.

Mr. Lancaster. I am with Mr. Bilbray.

Chairman LaFalce. Ms. Meyers.

Ms. Meyers. Thank you, Mr. Chairman. I am sorry that I was late, Mr. Chairman. I had three places to be at 9:00, and there is no way to do that I have found since I got here.

You all seem to be in agreement. I have been trying to scan the testimony of those that I was unable to hear, and you all seem to be in agreement that you want a strong and independent agency. And the other comment that seems to run through, if I am not mistaken, is the transfer of the minority business development from Commerce.

Is that a uniform feeling that you would be opposed to that?

Mr. Thomas. Well, we would be opposed to it. There are at least two others here who have expressed disagreement with me for some reason.

Ms. Meyers. And who of those are supportive of this concept? In other words, I am not sure that I understand what would happen if you took minority business development from Commerce and put it in SBA.

Would it just perform the same function there?

Mr. **Thomas**. Well, that is the problem. We do not know what it would do. Right now, as I said in my statement, the MBDA is not restricted by size standards as is the Small Business Administration. Minority businesses want to become large. And many of the minority business problems occur after they reach a certain point like $10 million in gross sales or $20 million in gross sales. Bad things start to happen at that point.

So the assistance is further required even at that point. The SBA is pretty much concentrated on small businesses with a minority business component in its 8(a) set-aside program. So we think that it could cause mass confusion, particularly with the constituents of the MBDA and the SBA right now.

Ms. **Meyers**. Was there fairly uniform agreement, I notice that it came up in a couple of those who testified, in not mandating health benefits?

Ms. **Price**. The Small Business Legislative Council, that is our number one priority, the opposition to mandated benefits.

Did you want to comment on that, Mr. Carroll?

Mr. **Carroll**. Yes, ma'am; we feel that small business people in general are against mandated benefits. But if Congress mandates health coverage without addressing the underlying problems of accessibility and affordability for small business, then we feel that they would be doing a disservice to the American small business community.

However, if Congress should mandate, which is conceivable, a minimum level of health coverage, our position is that we have included several alternatives for the Congress to consider, so that you will not be putting the small business people out of business because of increased taxes.

One of them happens to be the two key areas that we were looking at, and we discussed this with Kennedy's staff by the way, would be to mandate health coverage for everybody in the United States, not just small business people. That is so you would increase the size of the pool. And second, to provide a tax credit should the Congress, which has been discussed in some cases, have a 5-percent payroll tax. And we are asking that Congress give the small business person a 4-percent tax credit, for example.

Then, of course, we have a very serious problem going on right here now that we feel that the Washington Business Group on Health, and they are the agents for big business, is trying to just eliminate HMO's and whittle down the HMO Act by calling for elimination of the equal contribution status by companies as a first step of three to eliminate HMO's.

This is a serious problem that requires attention by March 16th, and that was the only reason that I brought that up in my testimony. It is very serious. I called on the SBA, and I called on the Members of Congress to at least register their complaint. I talked to Senator Proxmire and Senator Kennedy yesterday, and I know that we could use some help in that area.

But this would increase the HMO premium for every small business, every constituent of every Member of Congress, and every small business organization in this room. But it is sneaking right through, and that is the unfortunate part of it. So health benefits to us is a very serious problem. It is probably the number one issue in America today.

Ms. **Meyers**. All right. I appreciate it very much. Thank you, Mr. Chairman.

Chairman **LaFalce**. Thank you, Ms. Meyers. Mr. Gallo.

Mr. **Gallo**. Thank you, Mr. Chairman. And I want to thank all of you for your testimony. Some of it I missed, but it is in great detail, and I will be reviewing parts that I missed. And it is nice to be here at least at a point where we are not talking about the elimination of SBA, and going through that situation that we discussed and went through last year.

And also at the same time, the recognition by the President as far as the funding levels, at least maintaining those levels I think is a recognition of the need, the development, and the success that has taken place in the area of small business.

But there are some areas that do concern me. I know that there were comments made before, and I am talking with respect to the Small Business Development Centers. I missed Mr. Purdy's discussion on this, but I understand that you called for oversight hearings on the status of that program.

I can only speak from some of the experiences that I have had. First of all, let me ask a question as related to the budget that is presented by the President. It is my understanding that there would be significant losses to States.

Do you have a number of how many States would no longer be in the position to maintain their SBDC?

Mr. **Purdy**. Yes; the proposal is somewhat complicated, but I think that it can, to some extent, be cut through fairly easily. They are talking about lowering the cap from $65 to $45 million which is a population-based formula that determines a State's eligibility for matching funds.

It is our understanding that all States will receive a 30-percent reduction the first year and any States that are up against the cap will have an additional 20-percent reduction and then there will be a 20-percent reduction each year thereafter for a 5-year total phaseout.

In what that means, although in our discussions with the agency, I am not sure they understand the full implications, is that in the first year that 26 States will be reduced in Federal funding by 50 percent.

Mr. **Gallo**. Well, I think that the Small Business Development Centers have been a tremendous help in bringing small businesses into the marketplace. I had the experience of having a seminar in my own district, and used them as a catalyst.

I know that there has been some arguments that it is taking away from the private sector. I found just the opposite, because it brought in some of the private consultants. They were paid to do their job, but they were the catalyst to bring this all together.

And in this particular seminar, dealing with State procurement, Federal procurement and then trade, how small business gets directly involved exporting, and whether or not small business has the capabilities or the product.

A lot of small business might be interested in getting into export and find that there is really no place for them. And so by getting that information early, through the SBDC's they save a great deal of time and a great deal of money.

But I have found SBDC's to be one of the most helpful areas for small business whether it be minority small business or small business in general. And I would hate to see anything that would jeopardize as it would with the proposed budget. As I understand it, 26 States would have an immediate loss of funds.

And also, I think that it has been a good partnership between the State and the Federal governments which should not be overlooked, because it allows the cooperation and networking of both State and Federal agencies. So I am very concerned with that aspect and will be following that very closely.

Was there any general disagreement on the panel relating to this?

Mr. SHATTUCK. Mr. Gallo, I would like to support what you just said in terms of what the SBDC's have done to get into areas that nobody else would ever get involved in. It seems to me that the argument against SBDC's is that they compete with the private sector, and all we have to do is revitalize SCORE and the whole problem is solved.

First, let me say that back in 1976 and 1977 when we were talking about this legislation, we went to several private consultants and asked if they would oppose the SBDC concept and surprisingly they said no. It is because at the compensation level that this program is at, no private consultant could make a living at it.

Second of all, it basically gives an orientation for the small business firm to use outside resources so that they are not afraid of hiring a consultant as the company grows and prospers later on. So it does not compete with the private sector. You are absolutely right.

Number two, some 6,500 companies were helped in Massachusetts last year. They were asked in the course of their assistance if they could have obtained assistance at a price that they could afford had it not been for SBDC's and 95 percent said no.

Third, in all due respect to SCORE, the quality control at SCORE is spotty at best. You may walk into SCORE and get somebody who spent his life in shipping at Sears Roebuck. To put your company's life on the line without any qualifications, which they do not have at the SCORE program, is very, very dangerous at best, and it needs an awful lot of work.

In terms of using the private sector, SBDC's do use the private sector. In Massachusetts, 64 percent of all of the trainers are private consultants. So it is erroneous again to say that it competes with the private sector.

So it pains me to have to disagree with Mr. Carroll and NFIB who have been whipping SBDC's now for years, unfairly.

Mr. GALLO. Well, in conclusion, I just want to say that in this particular seminar that I went through, we had 250 pre-registered, and on a snowy day at Picatinny Arsenal in my district, we had 340 small business people show up. And the comments have not stopped since the day of that seminar as far as what they received out of it, and some of the successes that have developed as a result of it. So I thank you for your testimony.

Would you like to respond?

Mr. CARROLL. I told myself that I should not even put it in my testimony. I have been fighting this battle for many, many years, and I would like to set the record straight, Lew. I was one of the early supporters of the SBDC program when it was first developed within the National Advisory Council of the SBA. But I said then as I say now that once the SBDC's got off track and started to compete with the private sector that they would lose my support.

In terms of budgeting, if you talk 50 States at $4 million a State, you are talking a $200 million budget. All I am saying——

Mr. SHATTUCK. Frank, the Federal budget for SBDC's last year was $30 million, $30 million. In this town, $30 million, you lose it in paper cups.

Mr. CARROLL. I do not deny that. I am saying the trend. Second, in terms of the private sector, there is no question that they compete with the private sector, so I do not agree with you. On the other hand, I will say this. The SUNY New York SBDC, the Atlanta, GA, and Massachusetts, I think that they are the three outstanding ones, Florida, outstanding SBDC's. So there is no argument there.

I still see philosophically that the trend of the budget is going on, and the SBA budget is going down. We are fighting a deficit here that we are talking about reducing the deficit. And I am just saying that in terms of where you are going to put your priorities, that is why we were pushing for 100 employees or less for the SBA to cut the size standards down except for procurement areas.

But you know, I said that I would not argue the point, and I had to say it, but I do not want to take up the committee's time with my disagreement. We have more serious problems in health care that we have concerns.

Mr. GALLO. Thank you, Mr. Carroll. Thank you, Mr. Chairman.

Chairman LAFALCE. Thank you, Mr. Gallo. Mr. Hefley.

Mr. HEFLEY. Thank you, Mr. Chairman. It seems that many of you, and I do appreciate you being here today to give this good testimony, but it seems that many of you and many of us on this committee as a matter of fact regard as synonymous being advocates for small business and being advocates for the SBA. And I do not think that is appropriate certainly for the committee.

I would hope that all of us would be advocates for small business. I would hope that we as an oversight committee would be very critical of the SBA and try to make darn sure that it is doing what it ought to be doing for small business in America.

And I guess that I am not totally convinced that it is in some respects. Also, you know, the Federal Government is broke, and I think that we need to assume that there are no new dollars. And most of you have talked about this program and that program needs to be strengthened which I guess that means new dollars going into it.

So do any of you have suggestions for what the SBA is not doing very well that we could cut out, so that we could use those dollars to put into some of the things that you said need to be strengthened? Are there areas that the SBA is falling down on, engaged in those areas that they should not be in, or are they not doing a very good job in it, are there any suggestions on that?

Mr. **Shattuck**. I think that there is some duplication with what the SBA does and what other agencies do. For instance, the SBA is in the international trade assistance business. It is modest at best, but this is an area where probably Commerce ought to be more involved. But the reason why the SBA got into international trade assistance is because Commerce was shooting all of its programs at the very big companies, and not addressing the small business sector. So it started its own.

I think that there are other areas besides that are duplicated by other agencies of government. But they have not aimed their programs at the small business sector.

Mr. **Hefley**. Does anyone else want to comment on that? You know, we need help with this kind of thing. For you who are out there working with it every day to tell us what is not working, so that we know that and do not continue to throw dollars at programs that are really not doing that job.

Back to this Small Business Development Center thing, these university-based centers, you know, I do not think that there is any question that they do some good. But I think the question is should the Federal Government be funding them. Now this is the kind of thing that colleges and universities used to be doing in their communities as a service to their community, and to keep their professors and so forth on the front line, so that they are not completely theoretical in what they do.

The Federal Government came through with some money on it, and now we wring our hands and say, oh, by gosh, if that money is cut back, this will not be done.

Is that true, that that will not be done? Does the Federal Government have to be in this business?

Mr. **Purdy**. I think that the Federal Government has a very appropriate role in assisting small business which clearly as we all know is our main contributor to jobs creation and tax revenue generation in the economy. I think that part of the problem is a misunderstanding in terms of the university-based relationship with SBDC's.

Most SBDC's in fact do not exclusively use faculty consultants. We have a combination of resources that include private sector consultants, graduate and undergraduate student interns, volunteers, and other resources anywhere we can find them.

In my testimony, I mentioned that I think that the Federal Government's role here is mainly as a catalyst. And that when we do go out to leverage those resources from the private sector, the State, and other government agencies to help support small business, the Federal partnership in this plays a key role.

And I would suggest that the SBDC program should be used as a model as it has been in other programs both domestic and international to demonstrate the potential of partnership activities which have the ability to leverage substantial resources for the benefit of key sectors of the economy.

One way to expand assistance to small business is to continue the development of programs in which the government puts some resources behind activities, and then requires the local delivery agencies to go out and raise funds to match those and in fact exceed the match where possible.

I represent one of the oldest university-based entrepreneurial centers in the country, originally funded by the Kellogg Foundation. I have been in this business a number of years. And it is my sense that without Federal funding of the SBDC's, it would be, virtually impossible to keep our small business assistance network operating.

Mr. HEFLEY. Thank you very much, Mr. Chairman.

Mr. CROXTON. Excuse me, Mr. Hefley. I would like to address your concern that our requests seem to be asking for additional funds. Contrary to that, the SBA 503/504 program, as a result of moving out of the FFB and into the private market, has saved the Federal Government hundreds of millions of dollars in budget authority and outlays.

So we think that through efforts to improve and strengthen the 504 program we have saved Federal dollars as opposed to expending Federal dollars.

Mr. HEFLEY. Thank you.

Ms. STEVENS. Could I say something, please, Mr. Hefley. One of the things that we are recommending in the surety bond guarantee program is a revolving program. It is not getting additional funding, but reusing the funding that we have.

For instance, we give a contractor a bond for $100,000. It might only be a 30-day job. He goes in and he performs the job, and everything is completed, and yet that money disappears. It does not go back into the fund to be used again.

I have been in this program since the inception, and I still cannot figure out where the money goes. But it is gone, even though the job is completed. It is just a guarantee, it is not a loan. We do not give him any money. And yet the money is gone.

So what we are recommending is not additional funding for the program, but a revolving fund, so that we can put as the contractors complete the jobs that guarantee authority back into the program to be reused to assist the next contractor. Thank you.

Mr. HEFLEY. Thank you.

Chairman LAFALCE. Thank you very much. I really think it is important to understand what is taking place here, at least as I perceive it. We had an attempt for many years to abolish the Small Business Administration as it presently is constituted. And I think that virtually every Member of Congress, maybe not absolutely, but almost every member, Democrat or Republican, opposed that for both substantive reasons and symbolic reasons, because of the virtually unanimous belief in the Congress that it is important to have a separate entity devoted to the problems and opportunities of small business, and to stand for the small business community of America in the corridors of power in Government.

If we did not have a specific entity to stand up to other governmental agencies and for the small business community, I think that small business might get swallowed up within the struggles for power within Government. And if we did not have some services to the small business community, I think that the small business community would get very few services indeed. They simply would be unable to compete against these multinational corporations for governmental assistance that is needed in order to be competitive in today's marketplace.

Now when Congress, year after year after year, in a bipartisan or even nonpartisan fashion rejected that, we at long last witnessed a change. But the change may have been more tactical than strategic. The change may have been to do incrementally what could not be done with one fell swoop. So incrementally, the administration would eliminate the direct loan program, although the direct loan program is a small, small fraction of what it was. And it is now fairly well targeted to groups such as the handicapped, minorities, and Vietnam veterans.

The administration would, insofar as the guaranteed loans programs are concerned, tremendously increase their cost to those who want to avail themselves of it. Increase their cost to such an extent that many say that it will become financially prohibitive to even consider using that program.

I think that Ms. Price summed it up best when she said in her statement that we have to make a fundamental judgment. Either we spread the risks among all taxpayers, which we have traditionally done in having a Small Business Administration and its various programs, or we forego the opportunity of assisting small business.

The administration has also called for other things. We have come to a recognition within the Congress in the past decade that management and technical assistance could be fully as important as financial assistance, and, in some cases, even more important.

Therefore, we attempted to devise in our own imperfect way a delivery system for that which was better than the delivery system that existed, and we came up with the SBDC concept. It was imperfect when we conceived it, and it is probably imperfect now, but that does not mean that we should eliminate it. It means that perhaps we ought to perfect it.

What we are really seeing is a call for the elimination, over a period of 5 years, of the SBDC program. But because of the way that it would be phased out now, a drastic reduction in it would bring about a drastic reduction in the type of management and technical assistance as provided to the small business community.

Perhaps that is not necessary, some might argue. But then one could also argue if one believes that philosophically we should eliminate the Agricultural Extension Service. They are small businessmen with special agricultural needs. And I see no more reason for eliminating the SBDC's than I would for eliminating the Agricultural Extension Service.

And if the administration is going to do the one, surely it should do the other, and perhaps they should combine it in one bill, and we could consider that at that time.

There are a whole slew of other things, too, that we are going to have to consider in the weeks ahead. But I think that the overriding consideration is should Government be of assistance. We are not asking for huge sums of money. We are not asking for huge increases in assistance. We have accepted the fact that in nominal terms that assistance to the small business community is considerably less, and in real terms it is drastically less than it was in 1980, probably a greater cut in real terms than any other community.

But I think that we have come to the realization that enough is enough. That is not to say that we could not do a little bit more here or there. But by God, when your share of sacrifice has been perhaps 1,000 percent greater over the past six years than any other segment of America, I do not know that they should expect you to continue to make that much greater a sacrifice.

I think that with those remarks, not that I would like to, because I have so many questions that I would like to go into, but I would not even be able to scratch the surface, and I have two other meetings, one involving the recapitalization of FSLIC and the other with the Department of the Treasury and exchange rates.

So I am going to thank all the members of the panel for the fine testimony. I am going to thank all of the members of the full committee not only for their attendance but also for their great attention. The Committee on Small Business will stand adjourned. Thank you.

[Whereupon, at 10:46 a.m., the committee adjourned, subject to the call of the Chair.]

FISCAL YEAR 1988 SMALL BUSINESS ADMINISTRATION BUDGET

THURSDAY, MARCH 5, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Present: Chairman LaFalce; Representatives Torres, Olin, Mfume, Ireland, and Meyers.

Chairman LaFalce. The Small Business Committee will come to order. This morning we are concluding this series of hearings on the administration's budget request for the Small Business Administration for fiscal year 1988 which we commenced last week with testimony from SBA's Acting Administrator, Charles Heatherly.

Yesterday, we heard from representatives of small business associations. I must say that none of them were particularly enthused about the request received from the Reagan administration.

Today, we are pleased to welcome before our committee representatives of the National Federation of Independent Business, the United States Chamber of Commerce, associations of financial institutions and associations of venture capitalists. I am hopeful that today's hearing will be as enlightening and informative as yesterday's.

We have split our witnesses today into two panels—all of those mentioned with the exception of our venture capitalists which we will form as a separate panel.

Do any other members of the committee have a statement they wish to read?

Mr. Torres.

Mr. Torres. Thank you, Mr. Chairman, for providing me this opportunity. I certainly want to commend the chairman for calling these hearings. They are very important in terms of the agenda of the Small Business Committee and I welcome the witnesses today, some of whom I know.

Mr. Chairman, I have a conflicting commitment and I must leave this morning. I ask unanimous consent to enter my statement into the record.

The Chairman. Without objection, so ordered.

Mr. Torres. Thank you, sir.

OPENING STATEMENT OF HON. ESTEBAN EDWARD TORRES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

I want to thank Chairman John LaFalce for providing me with the opportunity to present the views of the Congressional Hispanic Caucus on the President's Fiscal Year 1988 budget proposal for the Small Business Administration. The Small Business Administration provides a number of essential services to the Hispanic business community. Proposals to change or eliminate SBA programs must be carefully scrutinized to determine their neccessity and desirability.

Hispanic businesses are an integral part of the nation's business community. With more than 360,000 firms nationwide and net receipts of over $18 billion, Hispanic businesses represent the largest and fastest growing minority business sector in the United States. By the end of this decade, Hispanic firms are expected to number one million and earn gross receipts of $150 billion.

While the past success of Hispanic businesses provide hope for a promising future, continued success is by no means guaranteed. Small and minority businesses are confronted with a number of fundamental problems that pose a serious threat to their success. Access to capital is limited, marketing opportunities are scarce, and technical expertise is difficult to accquire.

If Hispanic firms are to maintain and expand their current growth, these problems must be aggressively addressed by both government and corporate America. Federal programs and policies that are structured to assist Hispanic business development should be renewed and strengthened, not weakened or abandoned.

The budget submitted for the Small Business Administration contains a number of proposals that would dangerously undermine the opportunties currently available to Hispanic businesses. The direct loans that are often the only capital available to minorities would be eliminated. Business development expense grants would be abolished. Grants which provide technical assistance and counseling for minority firms would be cut in half and restricted to trade groups.

The Congressional Hispanic Caucus acknowledges that changes must be made in the Small Business Administration. Its resources are limited, increasing the importance of effective targeting. In addition, modification of some programs should be considered. For example, changes should be made in the 8(a) program to address glaring inadequacies and restore its integrity.

To achieve this, the program should no longer be subject to undue political influence. Congressional guidelines must be established to ensure merit is the primary basis upon which contracts are awarded. Realistic opportunities should also be provided for businesses to expand and develop until they can successfully compete in the marketplace.

Eliminating key programs and reducing vital services is not the answer. The Small Business Administration is important to the small businesses, and particularly to Hispanic businesses. Ninety-five percent of all Hispanic businesses are small. Some may have no reason to use the SBA, but many need, use and even rely on the agency's resources.

Hispanic businesses need a strong and effective Small Business Administration. They need an SBA that is sensitive to the needs of Hispanic owned businesses. They need an SBA that can help them compete for government contracts, obtain technical assistance, and raise the neccessary capital to grow.

I am confident that this committee will provide the necessary resources and make the proper changes in the Small Business Administration to ensure a strong, vital and effective agency.

Chairman LaFalce. Gentlemen, if there is no objection, we will put the entire text of your testimony into the record at the appropriate time, and then ask each of you to either read it verbatim or summarize it in approximately 5 minutes.

Our first witness will be Mr. John Sloan, Jr., representing the National Federation of Independent Business. Mr. Sloan.

TESTIMONY OF JOHN SLOAN, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Sloan. Mr. Chairman, thank you.

As mentioned, I am the president of the National Federation of Independent Businesses and we have over 500,000 small independent business owners, including members from every congressional district in the country. We thank you for making our statement a part of the record.

Let me say if I might, initially, that we consider these first hearings of the committee on the SBA's budget extremely important, and I myself am most appreciative of this chance to be here for a few minutes with you this morning.

We in NFIB are very encouraged by the approach you, Mr. Chairman, are taking. We are really particularly enthused and in complete agreement that the Small Business Committee should be aggressive on the economic issues affect small business other than those just SBA-related issues.

Your describing the committee as the ombudsmen for the small business community, I think, has raised some very positive expectations within the small business community.

The aggressive agenda you outlined in the Congressional Record last October and your subsequent public comments meet with great and enthusiastic approval in the small business community. Your staff has carried on your commitment to work closely with the small business groups and let me conclude this part of the testimony by thanking you very much for the role you are playing.

Let us look then at the role of the SBA itself for just a moment. Certainly the administration is to be commended on ceasing to raise the issue of eliminating the SBA. Therefore, we think we need to look at a very fundamental question.

The fundamental issue which we think needs to be raised by this committee, particularly with its new leadership and its new members, is what exactly is the most appropriate role for the Small Business Administration in affecting the growth and development of small business in America?

This committee needs to raise questions like who should the SBA assist and what kind of assistance should they be providing? Additional questions should also be raised such as whether the current programs are consistent in achieving the ends desired or are they unnecessary to the fundamental needs of the small business community?

The NFIB believes that the committee, by answering these types of questions, will better set spending priorities and program emphasis for the SBA. Knowing what the SBA should and should not be doing will allow the Congress to determine whether Federal spending for the agency is in fact a worthwhile public investment.

From that perspective then, let us take a look at the proposed SBA budget for fiscal year 1988. We at NFIB have, basically, mixed views of the administration's proposal. Looking first to their suggestion of business assistance to minorities, the NFIB would like to go firmly on the record of supporting the idea of transferring Minority Business Development Agency from the Department of Commerce to the SBA. We believe that that will strengthen minority business development and that the SBA is the appropriate agency to have that complete oversight.

We think entrepreneurs can have complete business packages through this effort and it will provide a better opportunity for mainstreaming the effort to assist minority business owners.

Another program mentioned in the budget is one that hits a consistent position for NFIB. We absolutely oppose continuation of the Direct Loan Program. We believe we can be sensitive to the needs of the handicapped, the minorities, and the veteran business owners. We think their needs can be handled by the more flexible Guarantee Loan Program.

Now I bring a bit of a bias to this issue because I spent over 20 years as a banker, as a bank president of a bank that was a certified lender with the SBA program. And I have seen the 7(a) Guaranteed Loan Program work very well. But I have also seen loans made, both direct and occasionally with guarantee, to people who have been turned down first by their banker; second, by the SBA as a guarantor; and then made a direct loan when any fair assessment of the loan application would say that the great odds are that it is going to fail.

Then, the great victim of the loan failure has not been the lending institution or the SBA. It has been the borrower themselves. You see the trauma that people are put through when they have not only lost their business, but also they have lost their home because the loan has a second mortgage. We can avoid a real human tragedy by not making a direct loan that should not have been made. I would urge you to look very carefully at the question of continuing the Direct Loan Program.

NFIB is strongly supportive of the Guaranteed Loan Program. In fact, in looking at what is happening there, we think that there is a particular innovative idea in the development stage that we are keenly interested in and think has a lot of merit and deserves some real study. That would be the model which we are seeing being developed through some ideas put together by Congressman Ireland.

The fact that he has taken an interest in this issue and is exploring ways of accomplishing the goal of privatizing the 7(a) program, I think, offers some real opportunity of actually broadening the availability of the Guaranteed Loan Program to a greater part of the small business constituency.

In the area of the Small Business Development Centers, Frankly, we see some SBDC's doing a good job. I would particularly like to commend what Bill Flewellen is doing at the University of Georgia, Dr. Price is doing out at Wisconsin, and the others.

But by and large, we do support the phaseout of Federal support for SBDC's. What we are seeing in States such as Connecticut where, for instance, the Traveller's Insurance Co. has made a major private commitment to that particular SBDC, and is funding from non-Federal sources. We believe it is possible for the private sector and the States to fund those programs where they are working. SBDC'S are an area that the Federal Government's direct support through the SBA effort can be phased out and can operate truly more efficiently.

We would oppose a proposal in the administration's budget of eliminating Pollution Control Contract Programs. We think that guaranteed effort to support pollution control programs would be one that should be maintained, but we think if it was transferred to the Environmental Protection Agency, it could be more effectively run.

We urge you, however, here on the Small Business Committee to make sure that the SBA maintains a certain amount of oversight of that program to ensure that it really works, somewhat the way that they maintain oversight in the procurement system.

As mentioned over the last years, the SBA is moving in the right direction when looking to pay for its services through expanded fees. In particular, we at NFIB have been very supportive of increasing the fee arrangement on the Guaranteed Loan Program because it should truly be paid for by the user rather than by the general taxpayer. It is a good program. We are appreciative of the support this committee has given and the Congress as a whole in raising those fees as you have done twice in the last 4 years.

Whether it is through the immediate up-front fee which is now up to the neighborhood of 3 percent, or whether it is actually like, for instance, FHA where there is a small fractional fee charged on an ongoing basis, the cost of the 7(a) program, ultimately, can be shifted to the user rather than to the general taxpayer.

Again, NFIB would urge the committee to maintain a keen oversight of user fees in order to assure that those fees remain reasonable and that they are not set too high. I think you would all be great watch dogs to make sure the proper oversight occurred

We have some real concerns in the area of sales of assets. On the front end, it superficially looks like a great idea. I think when we get to looking at it more closely, as you all will be doing, I would urge the committee make sure it is done in a way that the Government, on behalf of us taxpayers, gets top dollar for selling loans. Obtaining a few billion on a short-range sale at the expense of billions over the long haul is not an efficient way to deal with the deficit. So we would urge you to please watch this most carefully.

We continue to support the idea of COSBI and would urge you also, again this year, go forward. Maybe this is the year we can let the SBIC effort really move into the privatized area. We think that it is a great forerunner to the idea of privatizing the 7(a) program. We hope this will turn out to be the case.

We also will be supportive of H.R. 356, the initiative to raise the administrator to cabinet level. We think enactment will send a strong signal on the roll small business plays in the economy and I would earnestly request and urge your support for seeing the SBA administrator be elevated to cabinet-level status.

Mr. Chairman, thank you again for this opportunity of being here this morning.

[Mr. Sloan's prepared statement, with attachment, follows:]

PREPARED STATEMENT OF JOHN SLOAN, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

On behalf of the more than 500,000 members of NFIB, I appreciate the opportunity to outline for you, Mr. LaFalce, in your new capacity as Chairman of the House Small Business Committee, and to the other members of the Committee for the 100th Congress NFIB's views on the Small Business Administration (SBA). Furthermore, I would like to incorporate into this testimony comments on the Administration's proposed fiscal year 1988 budget.

NFIB's Membership

The National Federation of Independent Business is an association of small and independent businesses with over

500,000 members across the nation. NFIB members represent what could be called the "cutting edge" of the market economy. When the economy is growing, our members prosper. When the economy is in recession, NFIB members are the first to feel the brunt of reduced demand for goods and services. NFIB members have generally less than ten employees and a sales revenue of less than half a million dollars annually.

Our members are main street small businesses across the country. The membership reflects the wide array of enterprises in our economy, ranging from retail stores to manufacturers to general contractors to wholesalers.

With the permission of the Committee, I would like to include a breakdown of NFIB's membership (Insert #1). Because NFIB represents such an expansive spectrum of the small business community, we believe we speak for small business entrepreneurs who create the wealth and jobs for our nation.

SBA's Role for Small Business

Although the Committee has called these hearings to focus on the fiscal year 1988 SBA budget, NFIB believes this committee should raise a fundamental issue before the specific budget functions are decided.

The fundamental issue which needs to be raised by this committee, particularly with its new leadership and new members, is what exactly is the most appropriate role for the Small Business Administration in effecting the growth and development of small business in America? This committee needs to raise questions like, who should SBA assist and, what kind of assistance should be provided? Additional questions should also be raised, such as whether current programs are consistent in achieving the ends desired or are unnecessary to the fundamental needs of the small business community. NFIB believes that the Committee, by answering these types of questions, will better set spending priorities and program emphasis for the SBA. Knowing what SBA should and should not be doing will allow Congress to determine whether federal spending for the agency is, in fact, a worthwhile public investment.

We at NFIB are grateful that you, Mr. Chairman, have indicated a desire to look at the needs of the small business community and, subsequently, at the impact of the SBA on these enterprises. You have indicated that you would like to hold a series of hearings later this year on the changing American economy and its impact on small business. We believe these hearings will shed light on what role SBA should play. We hope that members of the Committee take an active role in planning the hearings and in participating in them.

Furthermore, between now and when hearings actually take place, NFIB would be willing to work with committee members and staff in providing data and expertise in looking at SBA programs.

There is no question in my mind that the House Small Business Committee does have a unique opportunity to look closely at the role SBA needs to play in the economy. We hope the Committee will take up this challenge and undertake a serious look at the fundamental questions which need to be asked and answered to make SBA a positive and productive agency for small business.

Administration's Fiscal Year 1988 Budget

The most important finding from our review of the Administration's proposed fiscal year 1988 budget is its commitment to retain SBA as an independent agency. We are thankful that the Administration has abandoned its counterproductive and futile move toward eliminating the SBA. Retaining an independent Small Business Administration signals entrepreneurs that the Administration wants to help, not hinder, small business owners. We were pleased with the President's statement last August 15 to the State Chairs of the White House Conference on Small Business about continuing SBA as a strong voice for small business in the Executive Branch.

Overall, we support the general thrust of the Administration's proposed budget. We are pleased that efforts are being made to reduce the federal deficit and to make the SBA more efficient and effective. However, we disagree with particular thrusts of the budget. I would like to look at specific programs, offering NFIB's critique and, where possible, additional constructive solutions.

Business Assistance to Minorities

NFIB supports the transfer of the Minority Business Development Agency (MBDA) from the Department of Commerce to

SBA. As outlined, the transfer will include 140 Full Time Equivalent (FTE) positions and approximately $24,000,000 in grants. The total amount of transfer from Commerce to SBA will be $35,798,000. Transfer of MBDA to SBA will strengthen the Minority Business program, while allowing the elimination of duplicative services. NFIB supports the consolidation for several reasons. First, we believe minority business assistance should be contained within one agency, and the most appropriate agency is the Small Business Administration. Second, transfer will allow minority business entrepreneurs to have a complete business development package available to them. Transfer from Commerce to SBA might also enhance the chances for a client-driven program. Third, and most importantly, NFIB believes that minority business enterprises want to be "mainstreamed" into economic affairs. Keeping the programs separate impairs the opportunity to ensure that minority entrepreneurs are full-fledged participants in the free enterprise system.

Direct Loan Assistance

NFIB advocates the elimination of the direct loan programs contained within the SBA. This committee is well aware that the direct loan program has been historically plagued by high default rates and a very high cost of delivery.

The direct loan programs have experienced reductions in both authorizations and appropriations over the last several years. Elimination of the remainder of the direct loan program will continue the direction this committee has taken in the past. While we are sensitive to the special circumstances handicapped, minority and veteran entrepreneurs face in obtaining funds for their enterprises, we believe these groups could obtain needed capital through flexible terms or adjustments to the SBA loan guarantee program. There seems to be no reason why the guarantee program could not accomplish this end, filling the void which may occur through elimination of direct lending.

Furthermore, the reform advocated will not cause significant undue hardship to the groups eligible for direct loans. In 1986, for example, only four percent of total minority borrowing came from direct loans; veterans also received four percent of total veteran borrowing from direct loans. Continued emphasis on deficit reduction, control of monetary policy to damper inflation, and incentives to increase savings for investment, and flexibility within the guarantee program would take up the slack from direct loan program elimination.

Restructure Guaranteed Lending

We appreciate the Administration's look at the guaranteed loan program. However, we would like this committee to go beyond the current structure of the program and think about a new approach to offer the same services to small business, while reducing the cost of the program to the government.

One innovative proposal which could be used as a model for other federal lending programs is the privatization of the Small Business Administration 7(a) loan guarantee program. A member of this committee, Andy Ireland (R-FL), has taken an interest in this idea and has been exploring ways to accomplish this goal with individuals in the private financial services sector. We believe his proposal has a great deal of merit and hope that the Committee will study its potential.

A privatized 7(a) would continue to serve the same basic constituency it now serves, with the same scope and with the level of federal involvement necessary to provide the same dollar-level obligations. We anticipate greater participation by the small business constituency, who continue to need long-term capital.

The 7(a) loan guarantee program provides long-term financing for small firms that cannot find a similar alternative in the private sector. The current program allows lenders to leverage assets through sales of guaranteed portions of loans in the secondary market, thereby establishing a vital capital flow between conventional investors and small businesses. In recent years, emphasis on the submission of "quality loans" for the guarantee and the development of a pooling mechanism for secondary market sales have significantly increased the efficiency of the program. But privatization of 7(a) could move beyond the strides that have already been made.

The privatized program would consist of a federally-chartered corporation enjoying a backstop line of credit from the U.S. Treasury. An interim program should involve maintenance of the SBA guarantee until such time as the new corporation is sufficiently capitalized to undertake guarantees. The corporation would facilitate the sale of corporate securities and pools of guaranteed loans. Sufficient fees would be charged by the corporation to eventually be self-funding.

The corporation would be subject to congressional oversight. Its board of directors would consist of representatives of small business, lenders, investors, and appropriate U.S. government appointees.

Small Business Development Centers

NFIB supports the Administration's budget proposal to phase out the federal funding of Small Business Development Centers (SBDC's). Gradual reduction in federal subsidies for SBDC's makes tremendous economic sense, especially with our current deficit challenge. A number of small business owners and states support SBDC's. The Administration's proposal will allow the states and supporters in the private sector to take over the funding responsibility. The proposal allows SBDC's the opportunity to experience a reduction in federal commitment over a three-year "maturing" period.

NFIB believes the Administration could even go further in the area of management assistance.

In fact, the Management Assistance Division at the SBA is a good example of good intentions gone awry. The program has grown over the years into the second largest program area in the agency. In 1986, MA spent close to $60 million in salaries and expenses to achieve their impossible mission: to provide counseling and training to small business owners who often won't admit they need help.

There is no question that poor management is a leading cause of business failure or that there is a real need to develop a network of quality assistance for small business owners. Some would question whether providing management assistance is a proper governmental function. More to the point for discussion is the fact that despite reorganizations, innovative approaches, and the combined efforts of a number of good people, the MA program area has the reputation of being the worst run, least effective division in the entire agency.

In a survey of our members, we found clear evidence to support these contentions. The delivery system for counseling small business owners obviously has an impact on the effectiveness of any specific program. An important aspect of counseling is trust. If the owner of a business does not trust the counselor, he or she will either not seek help or ignore the advice. We therefore asked our members who they most trust to provide business advice if cost were no consideration. Two clear choices were given: retired business owners and private consultants. Together they accounted for over 60% of first choice selections and 49% of second or backup selections. College and university business administration teachers were first choice for only 5% of respondents and second choice for 12%.

Besides supporting a more immediate elimination of federal funding for SBDC's, we would also advocate a thorough review and restructuring of the remaining MA efforts. In keeping with the small business preference, SBA's SCORE and ACE programs merit priority attention rather than the benign neglect they've been receiving for years. From a strictly educational standpoint, I would also like to mention the SBI program as being a low-cost effort which more than pays for itself by providing targeted assistance to business owners and practical, hands-on experience for graduate students, many of whom may someday own or manage businesses.

Finally, Congress' authorization for SBA to work with for-profit businesses to provide training and counseling will, we hope, lead to development of a private sector network which can ultimately be virtually self-sustaining.

If there is no dramatic improvement in the management assistance function, this committee should consider eliminating it.

Pollution Control Contract Guarantee Program

We are concerned about the Administration's proposal to eliminate the pollution control contract guarantee program. NFIB believes the program, instead of being eliminated, should be shifted to the Environmental Protection Agency (EPA) where it logically belongs. Housing the program in EPA would likely increase the resources available to the entrepreneur to meet federal regulations imposed on them.

The purpose of the program, which began over a decade ago, is to "prevent, reduce, abate or control noise, air, water pollution or disposal of solid or liquid waste." These needs have not diminished; many would argue more will need to be done in the future. It is unwise and counterproductive to simply eliminate the pollution control program.

If Congress would allow the program to be moved from SBA to EPA, we would advocate that SBA retain oversight to ensure the program goals are being achieved. This oversight function might parallel the efforts of the SBA procurement assistance division, where SBA oversees small business procurement opportunities within the Department of Defense and civilian agencies.

Disaster Assistance Eligibility

We believe the whole issue of where the disaster assistance program resides needs to be answered by the Congress. The Small Business Administration is a business agency, not an agency or department to help disaster victims. Furthermore, once Congress resolves this issue, we find nothing inappropriate in denying eligibility to those who can obtain funds from other sources. Changing the program, we believe, will serve as an incentive for applicants to use private sector sources and will target scarce funds to those most in need.

New and Expanded Fees

We are hesitant to openly endorse the entire array of new and expanded fees for SBA services and publications. There is no question that businessmen strongly believe that "there is no such thing as a free lunch." However, we hope that the SBA Administrator would not use fees to charge more than the value of the product or service provided to an entrepreneur. We would hope that this committee would perform the valuable oversight function in this area. We also hope the SBA would work closely with members within the small business community to determine the fee structure.

Sales of Assets

This particular aspect of the Administration's fiscal year 1988 budget proposal seems to be driven by the desire to reduce federal spending, and consequently the deficit. We applaud the desire of the Administration to reduce outlays. In fact, we are anxious to work with members from both sides of the aisle in obtaining sensible, significant deficit reduction. But while NFIB believes the role of government needs to be reduced, we are wary of this particular asset sale for two reasons. First, to our knowledge, there has been no objective source on how much the sale of assets, in this case the SBA loan portfolio, will mean in revenue to the government. Surely it does not make sense to sell loans below market value for short-term deficit reduction while losing the federal government revenue over the longer term. We understand, Mr. Chairman, that you have indicated an interest in this aspect of the asset sale issue. We commend you for your interest and ask that this issue of "objectivity" be raised fully before action is taken on the sale of the loan portfolio. We understand that the Committee is in the process of scheduling separate hearings to deal exclusively with this issue.

Our second concern over selling SBA loan portfolio assets is a result of our priority of privatizing the 7(a) loan guarantee program. Proposals to achieve privatization have relied on current guarantees to provide some of the capitalization for the federally-chartered corporation. Sale of loans would likely, in the short-term, undermine this larger effort.

Corporation for Small Business Investment

One initiative not raised in the Administration's fiscal year 1988 budget proposal is enactment of legislation creating the Corporation for Small Business Investment (COSBI).

Chartered by Congress, COSBI would be capitalized by $20 million in common stock furnished by SBIC's and other institutions interested in small business. COSBI would be operated like other federal corporations, such as FNMA an GNMA, issuing obligations rated as U.S. "agency" securities. It would have the authority to raise additional capital by issuing common stock to SBIC's as a condition of doing business with the corporation.

Governed by a permanent board of directors, consisting of 10 individuals elected by the shareholders and five named by the president, COSBI would assume the SBIC funding and regulatory functions now performed by the government. COSBI would establish the independent, private conditions necessary for growth of the industry and its clients. COSBI also would assume SBA's functions regarding MESBIC's.

As many of the committee members know, the combined growth of the SBIC industry and fiscal austerity has created a crisis in SBIC financing. Since 1981, the industry's need for leverage has exceeded authorization levels, forcing the SBA to allocate available funds, limit the amount each SBIC may borrow, and on several occasions, close the "loan window" completely. At one point, appropriations for MESBIC's were entirely exhausted.

Long-term financing relies on a level of certainty that changing federal rules and a shifting administrative posture have disrupted. Regulatory inflexibility and frequent government intervention have impeded the smooth operation of the SBIC marketplace.

NFIB hopes this committee, and the Congress, will move quickly to enact COSBI legislation. Enactment of this legislation was recommended by the delegates to the 1986 National White House Conference on Small Business.

Cabinet Level Status for the SBA Administrator

Another proposal missing in the Administration's announcement of its budget is enactment of legislation to elevate the SBA Administrator to Cabinet level status. We hope this committee will move quickly on a bill, H.R. 356, introduced by one of your colleagues, Rep. Andy Ireland, now before the House.

For too long, the SBA has been the neglected stepchild of the federal government. Yet, this agency represents millions of businesses across the nation which generate 70% of the net new jobs created for millions of Americans. Despite the obvious contributions small businesses make to our economy, their interests and concerns are too often overlooked during the development of national policies, because no one represents them within the highest policymaking circles.

H.R. 356 is necessary for many reasons. In these days of Gramm-Rudman-Hollings and program reductions, SBA has made a contribution to the process of budget reductions. While the small business community is willing to give up SBA programs, they are not willing to give up their independent voice within the government. Indeed programmatic cutbacks demand a strengthening of that voice.

Elevation of the Administrator to Cabinet level status will help accomplish tht goal at no additional cost to the government. The SBA will finally be given a clearly defined role in helping set national economic and social policies. The Administrator will be formally acknowledged as a member of the President's circle of close advisors, and other Cabinet officials will be unable to disregard the small business perspective in their deliberations.

Cabinet level status is also a powerful symbol. It is unquestioned recognition of the critical role small firms play in our economy; their interests must be given serious attention in the formulation of national policy. This is no different than the status already accorded trade decisions within our government via the Special Trade Representative's position on the Cabinet.

Conclusion

NFIB is pleased to present its views on the Small Business Administration and the proposed fiscal year 1988 budget submitted by the Reagan Administration. We support some of the SBA-related initiatives presented by the Administration, while urging this committee to go beyond what has been offered in other instances. NFIB is also concerned that other proposals, like the sale of assets, need to be looked at carefully before any action is taken.

We would also like this committee to enact COSBI legislation, privatize the guaranteed loan program, and elevate the status of the SBA Administrator to Cabinet level status.

We hope this comprehensive view of the SBA is helpful to the Committee. On behalf of NFIB, I would also like to again thank you for the opportunity to present our views.

Profile of NFIB Members

A. By Business Form:

Corporations	275,458	(53%)
Unincorporated	244,274	(47%)
Total Membership (Nov. 1986)	519,732	

B.	NFIB Membership By SIC Code	General Small Business Population By SIC Code*
Retail	30%	31%
Service	26%	21%
Wholesale	8%	11%
Non-capital intensive	64%	63%
Manufacturing	13%	10%
Construction	13%	12%
Agriculture	5%	2%
Transportation	3%	4%

C. Percent of NFIB Members by Gross Sales

Not Determined	2%
Less than $50,000	8%
$50,000 - 99,999	12%
$100,000- 199,999	15%
$200,000-349,999	14%
$350,000-799,999	18%
$800,000-1,499,999	13%
$1,500,000-2,999,999	8%
$3,000,000- or more	9%

D. Percent of NFIB Members by Number of Employees

1	7%
2	11%
3-5	27%
6-9	20%
10-14	12%
15-19	5%
20-39	9%
40 or More	8%
Not Responding	1%

*Source: The State of Small Business. A Report of the President, May, 1985

Chairman. LaFalce. Thank you very much, Mr. Sloan.

Our next witness will be Mr. John C. Rennie, representing the United States Chamber of Commerce.

TESTIMONY OF JOHN C. RENNIE, PRESIDENT, PACER SYSTEMS, INC., REPRESENTING THE U.S. CHAMBER OF COMMERCE

Mr. Rennie. Thank you, Mr. Chairman. I am Jack Rennie, president of Pacer Systems, a professional technical services company and also one that manufactures proprietary products principally for the aerospace and defense industries. In 1968, two fellows that I went to high school with and I founded the company with $10,000 capital. Currently, we have about 420 employees and a payroll of well over $10 million a year. So I am rapidly losing my small business credentials here. I may not be able to come back to testify as a small business person very much longer.

However, I want to point out that I have been helped at key times in the development of my company by the SBA. Twice in the financial program area; once with a SBIC investment, and once with a guaranteed loan. Also, I have been helped enumerable times in the procurement assistance area, management assistance, and in other areas, especially, advocacy and the outcome of advocacy.

So I know firsthand the value of SBA programs, and I certainly would not shrink at all from saying that SBA programs have been a meaningful contributor to whatever success I have been able to develop in my company.

Today, I am here representing the U.S. Chamber of Commerce Small Business Council, of which I am a member, and I am also one of the half-dozen or so small business people on the U.S. Chamber Board. With me is Tom Donley, the director, and Don Berno, the associate manager for legislation, of the Small Business Center at the U.S. Chamber.

I am very pleased to have the opportunity to comment on the fiscal year 1988 authorization for SBA. As some of the Members know, I have been actively involved in regional and national small business organizations for 10 or 12 years and have worked with the SBA closely on a number of issues, especially in the area of procurement, international trade, and management assistance.

So I am especially pleased that this year's budget proposal maintains SBA as an independent agency and we can concentrate not on the survival of SBA, but rather on ways to improve its programs.

Any budget proposal has to be viewed with an eye toward the immense Federal deficit. So responsible people realize that belt-tightening is in order, or at least efficiencies must be sought at a given funding level. But SBA, in our mind, has taken more than its share of cuts since 1981 when President Reagan first called for reductions in agencies' budgets and employees.

In parallel with these substantial cuts, the SBA, under Administrator Jim Sanders, was dramatically improved operationally. It is really a different agency now from the 1970's. So while we urge the committee to continue to find ways of savings and to increase reliance on the private sector in some areas, we, nevertheless, feel that SBA should not be on the defensive, but rather, held up as a model for other agencies regarding the way it operates and the way it has improved its delivery of services to its constituency, the small business sector.

With regard to specific proposals in the budget authorization package, I would offer the following comments.

With respect to direct loans, the U.S. Chamber supports the proposal to eliminate the direct loans. We feel that the Guaranteed Loan Program should be sufficient. There is often confusion between the programs. As someone who has been supporting SBA financial programs over the years, I have found when I testify and in other types of discussions and debates, that people confuse the different financial programs, and they will seize on what might be an exceptionally high default rate in the direct loan area and ascribe it to all the SBA loans. And we find it very hard to overcome that kind of grouping that occurs.

So both from a tactical viewpoint in the sense that, strategically, we feel that the Guaranteed Loan Program will work and that the vast majority of veterans, et cetera, using the Guaranteed Loan Program now, we think that is a supportable proposition.

With regard to guaranteed loans, as I mentioned, I can attest to the importance of this program and also leveraged credit programs, and therefore we are leery of administration proposals to lower the guaranteed percentages and increase fees.

We congratulate the committee for the improvement in the Guaranteed Loan Program in recent years, including the secondary market program, the preferred lenders, certified lenders, et cetera. So we would favor an initial thrust of finding ways to reduce losses and try to find savings. Rather than increasing fees perhaps we should first attack the loan management, the evaluation process, and incentavize the program to improve lender actions, and so forth, and their responsibility.

Then if additional savings are needed, an increase in fees could be considered. But only with a careful test of the increases to determine with high confidence that they do not undermine the program, perhaps a one-year trial or something, or perhaps even a survey of the financial industry that could be practically evaluated to see what the impact of this might be.

We will be very interested to hear the testimony of the financial institutions on this, this morning, and we feel that we would like to work with the committee, if possible, on that effort.

With regard to SBIC's, we applaud the effort to establish the Corporation for Small Business Investment, or COSBI, an area where greater private sector involvement makes a lot of sense to us.

We were disappointed that the House and Senate could not agree on the House-passed version last year, but we would urge the committee to reinitiate this action early this year.

With regard to asset sales, the only rational reason for selling assets would be to test the value of the portfolio. Otherwise to sell assets at a hoped for 30 cents on the dollar for a quick hit improvement in the deficit is not, in our mind, businesslike and not a good practice.

With respect to business development, we applaud the improvement in this area of SBA. By shifting some efforts to the role of coordinator of resources, instead of only providing hands on assistance, the SBA gets immense leverage.

With regard to SBDC's, these outfits are, to us, a good example of leveraging Federal funds, drawing in State and private sector funds. The program costs about $30 million annually, so it is not insignificant. But it also helps thousands of small business entrepreneurs.

For a perspective, the Department of Defense spends $30 million every hour throughout the year. In fact, the whole SBA operating budget in this proposal is on the order of one-tenth of 1 percent of the DOD budget.

So, while a move to more reliance on the private sector seems to be a good idea, it must be done carefully in our mind so that the program that has been so carefully constructed over the past 10 years or so is not destroyed.

If the program could eventually operate better without Federal funds, that would be the ideal solution. But the unevenness of the SBDC's themselves and their varying lack of resources and perhaps even the will to use the resources in different States must be carefully assessed before whole-scale adoption of the privatization proposal can be accepted.

With regard to the private sector initiative programs, we think these have been of great merit and have stimulated resources and creativity of other sectors on small businesses' behalf, and we would very much like to applaud what has been done and encourage more of it.

With regard to minority assistance, we strongly support the consolidation of Minority Business Development Agency into the SBA. We feel this will eliminate duplication and confusion and improve access in minority communities where most of the minority-owned businesses reside.

The U.S. Chamber would also like to see more effort in SBA to increase the linkage between the minority programs and mainstream programs such as SBDC's, SCORE, et cetera, to bring even more power to bear on budding minority enterprises.

With regard to SBIR, needless to say as one who was involved in trying to get it through the Congress, we feel a great deal of pride in its success to date. We also applaud SBA's role in this program which is vital in terms of early warning of solicitations, et cetera.

My company has won six awards itself, and has collaborated on seven others that have gone to smaller high technology companies.

The SBA's role should be continued in this program, and also we would urge that the SBIR be used as a model of sorts for other areas. For example, other improvements in the procurement system, international trade incentives and things of that nature. In other words, when we structured the SBIR we purposely tried to do things, streamline the proposal process, et cetera. That kind of approach I think might be very useful in other areas.

With regard to advocacy, needless to say, we think probably, and I think the small business community probably, increasingly perceives it as the most important function of a sort. And under Frank Swain's leadership in recent years, this office has flourished in its watchdog functions, the research it does, educational initiatives with public and private sector groups, et cetera. These efforts help all small businesses whether they know it or not.

In international trade, the Chamber agrees with a reassessment of this function in SBA. Small business is not being adequately served in trade matters. SBA should take an active role in our mind. With the current limited budget, perhaps it should just concentrate on information dissemination.

But in the future I could see an increased role in answering small businesses' biggest needs in trade. These are the general areas that always come up; incentives, education, improving the flow of marketing information, and accommodating imports and especially, unfair imports.

So in summary, we applaud the committee in having these hearings and we would like to continue to work with you to improve the SBA now that we do not have to worry about it being around.

Thank you very much, Mr. Chairman.

[Mr. Rennie's prepared statement follows:]

PREPARED STATEMENT OF JOHN C. RENNIE, PRESIDENT, PACER SYSTEMS, INC., REPRESENTING THE U.S. CHAMBER OF COMMERCE

Statement of the Chamber of Commerce of the United States

ON: SMALL BUSINESS ADMINISTRATION'S FUNDING AND PROGRAMS FOR FISCAL YEAR 1988

TO: HOUSE COMMITTEE ON SMALL BUSINESS

BY: JOHN C. RENNIE

DATE: MARCH 5, 1987

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents approximately 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 91 percent of the Chamber's members are small business firms with fewer than 100 employees, 58 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business--manufacturing, retailing, services, construction, wholesaling, and finance--numbers more than 11,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 56 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

My name is Jack Rennie, and I am President of Pacer Systems, headquartered in Billerica, Massachusetts. Pacer is an international business supplying professional technical services and hardware products to the aerospace civilian and military industry. With several partners, I founded Pacer Systems in 1968. In 1972, a Small Business Investment Company (SBIC) invested in Pacer and, in 1981, a Small Business Administration (SBA) guaranteed loan was a crucial part of another financing package. Today, Pacer has 420 employees and is listed on the London Stock Exchange.

I am a member of the Chamber's Council of Small Business and the Board of Directors of the U.S. Chamber.

Accompanying me today are Thomas E. Donley, Director, and Donald C. Berno, Associate Manager for Legislation, of the Small Business Center at the Chamber.

On behalf of the Chamber, I am pleased to have this opportunity to testify before the Committee on the Fiscal Year 1988 (FY '88) authorization for the SBA. I am pleased that the Reagan Administration's FY '88 budget proposal maintains the SBA as an independent agency, with most of its programs intact. The Reagan Administration has listened to the small business community, which made one of its top recommendations at the "1986 White House Conference on Small Business" that the SBA should remain an independent agency. It is now time for the small business community to join forces with Congress to ensure that the SBA operates efficiently and effectively.

I would like to present the Chamber's views on the Reagan Administration's proposals for the SBA's Credit, Business Development, Procurement, Innovation Research, Minority Assistance, International Trade, and Advocacy programs and to comment on proposed asset sales and user fees.

First, even though federal policy is not and should not be determined by the size of the national debt and the size of structural deficits, it is necessary to consider these problems.

When you live in a cage with a 400-pound gorilla, you have got to worry about him squeezing you every now and then. And, the SBA has been squeezed considerably since 1981, with full-time employees down from more than 5,000 to 4,200, its operating budget reduced from over $700 million in FY '86 to $525 million in FY '87, and $379 million in budget authority proposed for FY '88.

Balancing the budget by controlling spending ranked as the fourth highest recommendation of the "1986 White House Conference on Small Business." For the past 20 years, with the exception of 1969, the federal government has spent more than it has received. This is a concern for small businesses, not only because of the impact on capital markets but also because they know that an organization, even one as large as the U.S. government, cannot continue to operate on a deficit for an extended time.

From that perspective, the Chamber commends the House Committee on Small Business and the top management of the SBA during the Reagan Administration for helping to turn what was often perceived as one of the least effective and most wasteful federal agencies into one of the best managed federal agencies.

In this case, necessity has been the mother of invention, leading Congress to allow the SBA to institute programs relying on the private sector in order to deliver better, less expensive services to small businesses.

It is not easy setting priorities, cutting budgets, and implementing efficiencies, while maintaining valuable services; however, every successful business in the U.S. has done it, and the SBA can do it too.

The Chamber urges the House Committee on Small Business to continue to find savings and to encourage and direct the SBA to rely on the private sector.

THE REAGAN ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA

The budget proposals for the loan programs deserve close examination and thorough discussion by Congress, financial institutions, and the small business community. We urge the Committee, as it examines SBA programs, to keep the following points in mind. The development of business skills requires individual commitment and self-discipline. Programs to develop such skills by using tax dollars are implemented and best controlled on a local level with public-private cooperation and with clear accountability.

DIRECT LOANS

The Chamber supports the proposals to eliminate the direct loan programs. The SBA serves minorities, the physically challenged, and veterans in business better and less expensively through the guaranteed lending program. The fact that the vast majority of these individuals already utilizes guaranteed loans, rather than direct loans, indicates they have access to a network of private lenders in the U.S. and a credit distribution system unmatched in the world.

Succeeding in business is hard, especially for veterans who have sacrificed for our country, minorities who have suffered from discrimination, and the physically challenged who have to succeed first in overcoming physical limitations. For the truly physically challenged person who has the potential to succeed in business, initial financial support, backed by a government guarantee, can reduce dependency and give hope to other people.

GUARANTEED LOAN PROGRAMS

From my company's experience in receiving both a SBA guaranteed loan and a SBIC investment, I can attest personally to the importance of the SBA's guaranteed and leveraged credit programs as a source of long-term capital.

The Reagan Administration's proposals to lower the guaranty percentage and to increase loan origination fees should be studied carefully to see what impact they will have on lenders and borrowers.

The Chamber congratulates the Committee for introducing the improvements that Congress has made over the last several years in the guaranteed loan program. The expansion of the secondary market program and the expansion of the Preferred Lender and Certified Lender programs have improved program efficiencies and service delivery to the small business borrower.

The FY '88 authorization will offer additional opportunities. Since the SBA's loan portfolio and the annual authorization of new guaranteed loans represent the federal government's largest investment in the SBA, the greatest savings to be realized are in these areas. The Chamber believes that the government can find greater savings by reducing losses rather than by increasing fees in these areas. We urge the SBA to improve collections on loans that it is servicing and to determine whether more contracting out of collections would be cost-effective. Since 20 percent of the human resources of the SBA are committed to portfolio management, this is an area that could produce real savings through contracting out.

Next, we urge Congress to focus on the issues of lender risk and responsibility (including loan evaluation, management, and collection) and the incentives necessary to improve lender actions and increase lender responsibility.

Finally, we believe that there is potential for revenues to be raised through increased fees in FY '88. We have not heard of major problems with the increase in the loan origination fee in 1987. Possibly, it could be increased.

We are pleased to see that the Committee will hear from a panel representing the financial institutions this morning, and we look forward to hearing their analysis of these changes, not only of the impact of these changes on their organizations, but also the impact on borrowers.

We look forward to assisting the Committee in its efforts to reach that delicate balance between providing sufficient incentives to the lender to encourage careful analysis and keeping programs structured in such a way to maximize their use by the small business borrower.

SBIC PROGRAM

We applaud the efforts of the Committee and Congress to allow the SBIC program to rely on the private sector through the creation of a Corporation for Small Business Investment. We were disappointed that the House and Senate could not reach agreement on the House-passed version of this legislation last year and urge the Committee to act promptly on this initiative.

PROPOSED ASSET SALES

The Reagan Administration is proposing to sell a large percentage of the SBA's loan portfolios.

The Chamber agrees with Chairman LaFalce that valuable assets should not be sold to pay for current consumption. At the same time, we support a partial sale of assets--with different ages and maturities in each of the SBA's portfolios--to help determine the market value of the assets. This economic judgment on the quality of the SBA's assets should help the SBA and Congress evaluate the management and political decisions that have been made over time regarding the quality of the SBA's loans and should help the SBA make more creditworthy decisions in the future.

We look forward to working with the Committee as it proceeds with this issue.

BUSINESS DEVELOPMENT

Under the "Small Business Computer Security and Education Act in 1984," P.L. 98-362, the SBA received authorization to "cooperate with profit-making concerns" in providing management assistance to small businesses, along with constraints on promotion of the business sponsors' names and products.

The Chamber applauds SBA's efforts to transform the business development function from one of providing direct, hands-on assistance to one of serving as a coördinator of resources. SBA's creative thinking in this area has continued during its budget battles over the past two years and now should move full speed ahead. Through the Service Corps of Retired Executives (SCORE), Small Business Resource Centers in local chambers of commerce, and similar approaches, SBA has demonstrated that it can multiply its own budgetary resources. Since SBA has become a catalyst in cooperative efforts, it has helped to unleash the vast and diverse capacities of business and business organizations to serve small business. Thus, using its creativity, leadership, and information--in combination with private sector funds and know-now--SBA is leveraging a more effective total support system for small business.

SBA's PRIVATE SECTOR INITIATIVES

The Chamber believes that the SBA's private sector initiatives have been an unqualified success--for the SBA, for taxpayers and for small business users of the SBA's services. A case in point is the SBA's joint sponsorship of trade fairs and conferences on franchising with the International Franchise Association. The involvement of the SBA in this activity led to greater attendance by lower-income individuals who had not been attracted to these conferences before. This was a pilot project of the SBA's Private Sector Initiatives Office, which is now part of the Business Development Office. Another example is a joint project with Traveller's Insurance Company and Safeguard Business Systems to inform and to educate people about the potential of starting or improving home-based businesses.

The SBA's Office of Advocacy also has taken advantage of this flexibility, working very creatively with AT&T, Nynex, and other major companies to produce and publish high quality, substantive resource booklets. These activities complement the SBA's extremely successful 800-number telephone "Answer Desk."

We think the SBA's private sector initiatives have great merit and have stimulated the resources and the creativity of big businesses, trade and professional associations, chambers of commerce, and other organizations to assist small business people and individuals with business potential. One concern that the Chamber would like to raise with the Committee is the potential negative effect of the SBA's programs on private services because of "crowding out." If the SBA continues to sponsor programs with a select few companies on an indefinite basis, it is possible that these programs will so dominate the field that other private sector providers with the potential sponsor conferences and business development programs for the SBA's "customers" will be precluded from entering the field. The Chamber urges the Committee to review carefully the SBA report on these initiatives which will be submitted to the House and Senate Committees on Small Business on December 1, 1987, and to engage in oversight of this program in order to guard against these potential problems.

MINORITY ASSISTANCE PROGRAM

The Chamber supports the consolidation of the Minority Business Development Agency, which currently is located within the Department of Commerce, into SBA. There is no reason for the federal government to have duplicative minority business development programs at the SBA and at the Department of Commerce . Consolidation will eliminate duplication and confusion, will improve administrative efficiencies, and will streamline and improve SBA services in minority communities, where the vast majority of these businesses are located.

The Chamber believes that the SBA can best serve minority businesses through mainstream business development programs--Small Business Development Center (SBDC), SCORE, Small Business Institute (SBI), and other business development programs. These efforts could and do utilize minority trade associations to target minority business people for assistance. However, these individuals should be mainstreamed into broad-based SBA programs. The SBA can target programs to minorities most effectively and fairly by working through private sector organizations, such as regional minority purchasing councils, controlled by the private sector at the local level.

SBDCs

The Chamber supports strengthening SBDCs by having them rely more on the private sector. SBDCs are a good example of the SBA's ability to leverage state funds to improve the teaching of business skills. However, the program has been inconsistent, working well and being prudently managed in some states and not so well in others. Also, it has grown quickly and now costs the federal taxpayer over $30 million annually.

From the initial legislative debates on this program, there has been disagreement over whether SBDCs should be primarily university-based and publicly funded or should involve private funding and have more business control, while drawing on the resources of universities. From the start, the Chamber has supported the latter approach.

We believe that the concept of utilizing the talents and resources of our universities to make business people more effective and to help develop local economies is praiseworthy. Now that the federal government has introduced successfully the program, it should begin to phase out its funding and control. The Chamber believes that the states and the business community have the resources to fund and manage SBDCs, with limited federal control, as is the case with the agricultural extension programs.

We encourage this Committee to look at the Indiana SBDC program, in which the state chamber of commerce and major local chambers have become involved directly in funding and managing the SBDC program. The barriers to entry for the Indiana chambers were significant, and other such transitions to greater private sector involvement will continue to be difficult if this problem is not addressed by Congress.

The Chamber does not have the expertise to evaluate the Reagan Administration's five-year "phase out proposal." But we think the proposal is moving in the right direction. Without some planned phase out, it is unlikely that the SBDC program will rely more heavily on the private sector.

SMALL BUSINESS INNOVATION AND RESEARCH (SBIR) AND PROCUREMENT ASSISTANCE PROGRAMS

The SBA should continue its important role in the SBIR program and Procurement Assistance program. Despite concerns with implementation of the SBIR program at a few agencies, these programs have stimulated competition in government purchasing and have tapped small businesses' tremendous capabilities in research and development for government programs. The cost savings far outweigh the minor administrative costs. In fact, the SBIR is a successful model that can be used to encourage the government to leverage private sector resources to address other national problems.

We also are pleased that the SBA is moving ahead with the "Break-out Procurement Center Representatives" initiative, as required by P.L. 98-577. This initiative holds great promise.

OFFICE OF ADVOCACY

The Office of Advocacy is extremely important as an executive branch "watchdog" to raise small business concerns regarding proposed legislation and regulations. Also, its work in answering small business owners' questions, monitoring existing laws and regulations, forming a data base, initiating research on small business problems, educating state and local policymakers, and promoting public awareness of the contributions of small business is one of the most cost-effective activities in the federal government.

The Office of Advocacy has become more user-friendly through its "Answer Desk" and its growing data base of useful information.

INTERNATIONAL TRADE PROGRAM

The Chamber supports the planned reassessment of the SBA's International Trade program. Because the SBA has such a small international trade budget--less than $900,000--it should concentrate on information dissemination and education support to identify potential small business exporters and to link them with needed information and assistance. There are many creative ideas and initiatives emerging from business, export trading companies, trade clubs, port agencies, state and local governments, and federal agencies, including "Export SBIR" (Recommendation 35 from the "1986 White House Conference on Small Business"). The International Trade Office could play an important role in disseminating these small business ideas and programs.

The International Trade Office also should consider studying how small businesses' problems caused by unfair imports could be addressed. Many small businesses are unable to defend themselves from unfair imports, even when they have recourse to do so, because they do not have the time or money to present convincingly their cases to the Customs Service, the Import Administration, or the International Trade Commission. Perhaps, some International Trade Office funds could be spent on training the "Answer Desk" personnel to address basic international trade questions. Also, consideration should be given to coordinating with public liaison staff in the appropriate agencies on how they can respond more effectively to small businesses' problems.

We commend the Deputy Administrator's initiative to have the SBA's National Advisory Council's International Trade Committee meet with the SBA's international trade staff and business development experts to develop improvements in service. This meeting will take place on March 24, 1987. The Chamber and the U.S. and Foreign Commercial Service have engaged in a similar exercise, in which a business task force of Chamber members reviewed the U.S. and Foreign Commercial Service's programs and suggested improvements. The Chamber would be pleased to offer assistance to the SBA as well. Parenthetically, the Chamber commends the SBA's staff for seeking the advice and counsel of the National Advisory council through Task Forces on User Fees, the Section 8(a) Program, and Size Standards.

USER FEES PROGRAM

The SBA has conducted a thorough study on user fees, which it submitted to Congress on September 30, 1986. The SBA has continued studying and making recommendations on user fees for different services with an in-house Task Force and with a National Advisory Council Task Force. The Chamber supports reasonable user fees for federal government services as a way of placing the cost of a service directly on the beneficiary and as a legitimate revenue-raising activity when the user stands to receive a substantial benefit from the government service.

The Chamber has not evaluated the reasonableness of the proposed user fees. We commend the SBA for its diligent work in studying and recommending these user fee proposals. The true test of the reasonableness of the user fees will be in their effect on users. The Chamber would not object to imposing new user fees on a range of services for a one-year trial period. If use is reduced significantly, then the SBA and the Committee on Small Business should reevaluate both the usefulness of the program and the user fee level.

It is reasonable and proper for the federal government to charge user fees for services to business, but even more so in light of the current federal deficit and debt crisis.

SUMMARY

The FY '88 budget proposal for the SBA presents an opportunity for improved operations and reduced federal expenditures. The Chamber looks forward to working with the Committee and with Congress as a whole to create a SBA that can serve as a model for every federal agency in terms of operational efficiency, use of private sector resources, and delivery of effective programs for the American people.

This concludes my testimony. I will be happy to answer any questions that you may have.

Chairman **LaFalce**. I agree with much of your statement, but some might say we do not need your type of improvement. I guess it is all a question of definition.

Our next witness is H. Bruce Lansaw, senior vice president of First Huntington National Bank, representing the American Bankers Association.

TESTIMONY OF H. BRUCE LANSAW, SENIOR VICE PRESIDENT, FIRST HUNTINGTON NATIONAL BANK, HUNTINGTON, WV, REPRESENTING THE AMERICAN BANKERS ASSOCIATION [ABA]

Mr. **Lansaw**. Thank you, Mr. Chairman, and members of the committee.

I am with First Huntington National Bank in Huntington, WV, and chairman of the American Bankers Association's Small Business Banking Committee. The combined assets of ABA members comprise approximately 95 percent of the total assets of the commercial banking industry. While our members range in size from the smallest to the largest banks, 85 percent have assets of less than $100 million. I welcome the opportunity to present the ABA's views on programs of the Small Business Administration, while acknowledging the difficult realities of Congress' efforts to reduce the Federal budget deficit.

The First Huntington National Bank has $450 million in total assets, is actively involved in SBA programs. First Huntington currently serves the tri-State area of West Virginia, southern Ohio, and eastern Kentucky. The bank has been a SBA lender for the past 15 years and is currently a preferred and certified SBA lender. We have $8 million outstanding in SBA guaranteed loans, and these loans aid 80 businesses directly and many others, indirectly. The range of businesses served, including startup and mature companies, has provided many benefits to our market area. My bank's position is not unique in terms of active SBA involvement by ABA member banks.

Mr. Chairman, the banking industry has been a major participant in various SBA programs for years. Approximately 10,000 banks have been involved in SBA loan programs. A primary example is the loan guarantee program, which was authorized by Section 7(a) of the Small Business Act of 1953.

This program benefits the national economy and small communities through the jobs created and revenues produced by the small businesses that use the program.

The following highlights the ABA Small Business Banking Committee's position on certain pertinent SBA programs.

The 7(a) Guaranteed Lending Program should be continued at the present guarantee fee and guaranteed percentage levels, and the certified and preferred lender programs should be supported to attract a greater number of qualified participation banks.

The 504 Program should be continued. Secondary market access should be maintained and the SBIC and MSBIC Programs have merit. This is a position which we feel is consistent with the basic wishes expressed by small business at last year's White House Conference.

The ABA has consistently supported the 7(a) Loan Guarantee Program because it does provide benefits to small business, including access to important longer term financing.

As you stated very well in your presentation of the small business agenda on the floor of the House last October, Mr. Chairman, small businesses are major creators of new jobs. They make substantial contributions to our national economy. The SBA Loan Guarantee Program is a very real factor in enabling commercial banks to assist all small businesses, but especially new startup companies that desperately need long term financing.

The ABA has consistently supported the 7(a) Loan Guarantee Program because it benefits small businesses by providing this very important long-term financing. In 1985, during the debate over reauthorization of SBA, the ABA supported increasing the guarantee fee for these loans from 1 to 2 percent, and reducing the maximum guarantee from 90 percent to 85 percent for loans over $155,000 to reduce the cost of the program and contribute to reducing the Federal deficit. These changes were made and are now law pursuant to P.L. 99-272.

These reduced guarantee levels and increased fees have been incorporated into the reauthorization of the SBA. However, the ABA opposes attempts to further reduce the guarantee levels or increase fees, at least until the SBA must be reauthorized in 1989.

The SBA guarantees are also important to banks in part because the guarantees protect the safety and soundness of the financial institutions and satisfy bank regulators while more credit is provided to small businesses that could not otherwise secure long-term financing at reasonable interest rates.

These loan guarantees permit longer term amortization of loan repayments, thus reducing cash flow pressure and contributing to business growth and economic development.

If it is desirable to maintain this public policy in support of small business, then current guarantee levels and manageable debt service for small businesses should be maintained. Therefore, we oppose the administration's budget proposal to reduce the maximum loan guarantee to 75 percent by 1992.

In May 1985, my predecessor as ABA's Small Business Banking Committee chairman, John McClure, testified before this committee. I would like to quote from his testimony concerning loan guarantees:

> The 7(a) Loan Guarantee Program already transfers much of the administrative and servicing expense to the lending banks. This results in a cost of delivery to the Federal Government which should compare very favorably with the efficiency and cost of other federally sponsored economic development or public assistance programs. To help fund program costs, we support a guarantee fee of 2 percent. However, we think any increase above that percentage would retard bank participation in the program.

The ABA's Small Business Banking Committee recently met and reaffirmed this position. Increasing the guarantee fee, whether charged to the borrower or the lender, will retard bank participation.

The ABA's Small Business Banking Committee opposes the administration's proposal to charge lenders 20 percent of earnings on the sale of the guaranteed portions of SBA loans into the secondary market. Congress passed amendments in 1984 to facilitate the development of this secondary market as an incentive to lenders to participate in the program.

The secondary market works. It is an incentive for lenders. Further, in capital poor areas, these loan sales help lenders' liquidity by returning funds to the originating bank which becomes available for additional lending to small businesses. Although lenders sell the guaranteed portion of the loans, they retain loan servicing in the unguaranteed portion and their relationship with small business customers.

To impose a new charge on the income earned from these sales into the secondary market will negatively impact the purpose of the 1984 amendments that expedited its development. Due to the infancy of these changes, time is needed to permit their maturity. Such a fee, at this time, would virtually kill this program and would retard lender participation in the 7(a) Guaranteed Loan Program.

Last, the ABA Small Business Banking Committee does not oppose the sale of SBA's loan portfolio in principle. However, when such sales are contemplated, we believe strongly that the best possible terms for the sale must be obtained and only if the sales benefit the ongoing SBA loan program. We urge this committee to examine carefully all proposals to sell the SBA's loan portfolio, and to support such sales only if they will benefit the goal of continued Federal support for small business while accomplishing the complementary purpose of effectively reducing the Federal deficit.

In conclusion, Mr. Chairman, the ABA's Small Business Banking Committee continues to support the SBA and its programs. We believe that the actions taken during the reauthorization of SBA to reduce program costs were responsible. We are working with the programs. Making further changes in these programs such as reducing the guarantee levels or increasing fees will reduce program participation, and not just because the change in loan terms will make the programs less accessible to some small businesses. Program participation will be reduced if such changes are made because yearly uncertainty about SBA loan program terms results in frustration and lack of interest on the part of small business borrowers, lenders, and the SBA staff.

For example, a bank which decides to be qualified and active in SBA guaranteed lending must make a resource commitment in order to properly participate. Banks will be reluctant to make the appropriate resource commitment if the viability of the SBA is in doubt.

The SBA programs supported by the ABA Small Business Banking Committee and in which many of our member banks are participating work quite well. If changes to these programs are contemplated, they should be examined during the reauthorization process in 1989.

Mr. Chairman, the ABA would be pleased to work with the members and staff of this committee as you continue your review of these programs. I will be pleased to answer any questions that you may have.

Thank you.

Chairman LaFalce. Thank you very much, Mr. Lansaw.

Our next witness will be Mr. Clyde D. Garrett, senior vice president of Allied Capital Corp., representing the National Association of Government Guaranteed Lenders.

TESTIMONY OF CLYDE D. GARRETT II, VICE PRESIDENT, ALLIED CAPITAL CORP., REPRESENTING NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS [NAGGL]

Mr. GARRETT. Mr. Chairman, I thank you and the members of the Small Business Committee for allowing me to talk with you today.

As you introduced me, my name is Clyde Garrett. I am a member of the board of directors of the National Association of Government Guaranteed Lenders, commonly referred to as NAGGL. I am also senior vice president of a Washington, DC-based firm called Allied Capital Corp. Allied Capital is a publicly traded company, managing assets in excess of $110 million and has a subsidiary, Allied Lending Corp. which specializes in making Small Business Administration guaranteed loans. In fact, Allied Lending Corp.'s only business is providing long term commercial loans guaranteed by SBA.

My representation here today is on behalf of the members of the National Association of Government Guaranteed Lenders. Our membership comprises some of the most active SBA lenders in the country. This includes banks and nonbank lenders. We believe that we are experts in the field of quality-oriented SBA loans and have vast experience with borrowers that request this type of long term financing.

We, obviously, believe that SBA is an important agency of the United States Government and that SBA provides a vital and necessary service to the small business community. Elimination of the agency or its financial services would create a void in the long term credit markets that would not be filled by traditional short term bank financing. Long term financing enhances not only a small businessperson's ability to plan for capital needs, but also to enhance cash flow.

We believe that proposals submitted for the budget year commencing October 1987 would be detrimental not only to the Small Business Administration, but also to the long term credit availability for the small business community. These proposals would directly force lenders away from making SBA loans; thereby eliminating funds to the small business community and severely hurting one of the most vital segments of our economy.

Specifically, the proposals that we cannot work under are as follows:

First, charging lenders 1 percent of the guaranteed portion of loans. Lenders accept risk in each SBA loan that they make. Charging a 1-percent fee reduces the potential profitability from a loan and creates a negative inducement for lenders to invest funds. It impacts the viability of the commonly referred to risk-reward concept. The loan risk remains the same, but the lender's financial reward is reduced.

Second, charging lenders 20 percent of the premium earned on the sale of the guaranteed portion of loans in the secondary market. This fee adversely affects the available profit to a lender. Lenders sell loans in order to generate profit. Reduction of profit potential will induce lenders to look elsewhere to maximize profit opportunities.

Third, reduce the guaranteed portion of loans to a maximum of 75 percent. This is completely unacceptable to lenders because it reduces their leverage capacity to only 3 to 1. It was originally 9 to 1, and in April 1986, it was reduced to 5.67 to 1 by a reduced guaranteed level of 85 percent. This proposal will undoubtedly impact lenders severely. Besides increasing loss exposure, it will drastically reduce the leverage potential by increasing the lender's capital requirements. The increased capital requirements will make the loan guarantee program infeasible for most of SBA's more active and most quality-oriented lenders.

Lenders depend on the SBA guarantee to be able to sell part of the loan in the secondary market and generate more capital to make small business loans. This is the same process used by FHA to supply funds for housing loans.

When the guarantee level was reduced from 90 to 85 percent, it increased the amount of capital a lending institution had to put in each loan by 50 percent; because on each $100,000 loan the lender could only sell off $85,000 not $90,000. The lender had to put up $15,000 instead of $10,000. The last reduction in the guarantee level has already reduced the capital available to small business by 50 percent.

This new proposal will mean another reduction in the capital available for small business. This time, there will be a 67-percent cut in the capital available. A lender will now have to put up $25,000 in capital for each loan instead of $15,000.

This cut is so great that it will drive lenders out of the market of making SBA guaranteed loans. Profitability will have been reduced from a gross margin of approximately 27 percent to approximately 18 percent. No lending operation can exist on a gross profit margin of 18 percent. And gross profit margin is before all expenses including overhead of salaries, rent, and loan loss.

I must repeat to you that my company, Allied Lending Corp., would have to stop operations in the SBA guaranteed program if Congress lowers the guarantee. This will mean the loss of jobs in my own group, and also a loss of funds to small business who employ many new people.

Another way to consider the reduced guarantee level of 90 percent to 75 percent is that lenders are being asked to increase their capital requirements by 150 percent. How many businesses could survive in this type of environment. Whether large or small, a capital requirement increase of 150 percent will put companies out of business and eliminate the availability of long term financing to the Nation's small businesses.

Furthermore, through the use of fees, it has been projected that revenue of approximately $60 million will be generated. This is a fallacy. It assumes that both lenders and borrowers remain active in the Loan Guarantee Program. This will not happen. At a minimum, lenders will leave the program reducing not only the projected revenue, but eliminating available long term capital to the small business community

The fact is, that the Guarantee Loan Program is the only mechanism that permits small business to receive funds from the large U.S. capital market. These guaranteed loans are sold to large pension funds, insurance companies, and other large institutional investors; none of whom would ever make a small business loan, but all are buyers of Government guaranteed paper, and by purchasing these loans they use their enormous capital to aid the growth of small business throughout the United States.

While all Americans want to have the Federal budget balanced, we feel that active SBA lenders and the small business community have worked to achieve this through the reduced 85 percent guaranty and the increased fee of 2 percent to the borrowers effective April 1986.

It has only been 11 months since these changes to the program were implemented and already further changes are being proposed. In a time where lenders and borrowers have compromised and accepted a reduced guaranty and increased fees, we propose that the administration refrain from attempting yet again, to dismantle the Small Business Administration or to make its programs so costly and so impracticable as to render them useless.

The proposals that have been made to modify the SBA program will make that program financially unattractive to lenders. If enacted, these proposals would have the same effect on the small business community as if the agency itself were eliminated. It will force lenders to leave the program, eliminate capital availability and adversely impact the small business community.

I ask you not to dismantle or allow to be dismantled such a valuable program. The SBA program creates the availability of long term financing to the small business community; a community that represents the grass roots of this great country of ours. SBA loans help in job creation as well as increasing the local tax base through increased business revenues.

Members of the committee, I thank you for the opportunity to express these facts and thank you for your time.

Chairman **LaFalce**. Thank you, Mr. Garrett, for your very excellent testimony. It will be extremely helpful.

Our next witness and the last on this first panel will be Mr. Gordon H. Ochenrider III, executive vice president of Mountain Bank of White Fish, MT, representing the Independent Bankers Association of America.

Mr. Ochenrider.

TESTIMONY OF GORDON H. OCHENRIDER III, EXECUTIVE VICE PRESIDENT, MOUNTAIN BANK, WHITEFISH, MT, REPRESENTING INDEPENDENT BANKERS ASSOCIATION

Mr. **Ochenrider**. Thank you, Mr. Chairman. My name is Gordon Ochenrider, the executive vice president of the Mountain Bank in White Fish, MT. Our bank, with $32 million in assets is a typical community bank. Located in rural northwestern Montana, our community is dependent on the woods product industry, tourism, and transfer payments.

I have been asked here today as a representative of the independent, community bankers who participate in the 7(a) Guaranteed Loan Program. As the largest SBA lender in Montana for the past 4 years and one of the top volume SBA lenders in the country, we have experienced the many benefits of the SBA Guaranteed Lending Program. We are currently participants in the SBA certified and preferred lenders programs. Since my association with Mountain Bank in 1973, the SBA has never had a charge-off loan originated by Mountain Bank.

In the 1930's, 1940's and 1950's, the Department of Commerce, the Federal Reserve Board, and others conducted independent studies of small business financing. They all concluded that a serious credit gap existed for small firms because access to the capital markets was limited and banks were and continue to be reluctant to lend money on a long-term basis. Section 7(a) of the Small Business Act authorized SBA to guarantee loans made by private lenders to small businesses that cannot otherwise obtain reasonable long-term financing. The 7(a) program offers terms and conditions that fit the needs of both the small business borrowers and the lenders.

The GAO also did an extensive survey of 9,000 banks in 1983 and concluded that the 7(a) program was the Federal Government's answer to the small business need for long-term financing. The GAO estimated that approximately 40 percent of all loans to small businesses, both long term and short term, had an SBA guarantee. The survey's conclusion was that the Guaranteed Loan Program has encouraged lenders to finance new ventures and to make longer term loans. Furthermore, data from the Senate Small Business Committee [SBA: A Mission Accomplished, March, 1985] indicated that almost 70 percent of all loans to small businesses with terms over 5 years have SBA guarantees. In Whitefish, as in many undercapitalized rural communities across America, over 90 percent of all loans to small businesses with terms over 5 years have SBA guaranties. Community banks account for 83 percent of SBA loans made in Montana.

My comments today will focus on two of the administration's budget proposals for SBA, one to increase the guaranty fee on the 7(a) loan program from 2 to 4 points, with 3 points being paid by the borrower and 1 point being paid by the lender. The other is to reduce the guaranteed percentage from 85 and 90 percent to 75 percent by 1992. Either of these budget proposals could represent a devastating blow on the 7(a) loan program.

Given the importance of small businesses to our national and local economies, it is crucial that the SBA Guaranteed Lending Program be maintained to provide small businesses with viable financing alternatives. Furthermore, it is important that the 7(a) program be affordable to borrowers by keeping the fees as low as possible and attractive to lenders by retaining a high guaranteed percentage for the loans.

The current budget proposal to raise the guaranty fees from 2 to 4 percent, with lenders paying 1 of the point fees, is very likely to price some borrowers out of the market. It is both unlikely and unrealistic to believe the lenders will pay the 1 point fee. This fee will be passed on to the borrower, most likely in the form of a higher interest rate. Also, services, such as loan document preparation, which many institutions like ours presently provide to borrowers for free, would no longer be free.

The 4-point guaranty fee proposal works directly against the people and businesses the SBA was specifically designed to assist. Increased fees are in reality another form of hidden taxation and should not be referred to as a guaranty or a user fee. I firmly believe that the 1-point fee increase of last year was too much and I can prove in our bank that 1 percent is adequate if the program is used correctly.

Raising fees is not always an automatic answer for cost and overhead problems. Often, markets simply will not bear an increase in costs. However, overhead can be reduced with some streamlining and internal cost cutting measures.

We believe a study should be done internally in SBA to see what layers could be eliminated to make the SBA more efficient and cost-effective. The SBA program is still the only source of long-term capital for small businesses. Let us not price it out of the market for the sake of covering unnecessary overhead expenses.

In lieu of a fee increase, several steps could be taken to improve the quality of SBA loans. The first step should be to place greater reliance on the private sector by allowing the certified and preferred lenders to assume more responsibilities in return for additional benefits.

Presently, the Certified Lender and Preferred Lenders Programs place responsibility for the loan application analyses with the lending institutions rather than SBA personnel. Lenders who have attained the CLP or PLP status have earned or should have earned this special status.

However, SBA personnel are still reviewing these loans as if the lender has had no expertise. Does SBA need to conduct such a detailed review for PLP loans? This would seem to be a prime target for SBA to do a program modification while not sacrificing loan quality.

For example, I approved an SBA loan under the Preferred Lenders Program in the amount of $272,000. It is a small amount really, but it is a typical loan. I did not want to pick one that did not fit the norm. Mountain Bank prepared all the documents and closed the loan. The SBA office did review our documents which could not have possibly taken over 2 hours and collected a guaranty fee of $4,125.

I would also like to note that this long-term fixed-rate loan, our borrower increased his number of employees from 22 to 55 people and his total payroll for 1986 amounted to $792,000 in a high unemployment area. It is in Lincoln County, and I believe unemployment there is about 12 percent. This business contributed $259,000 in tax payments to the Treasury in 1986.

I would think that the Government, in this instance, got its money back for the SBA's personnel and they now have $4,000 as a guaranty fee in case the loan goes bad.

The second step to take would be to review the SBA loan underwriting standards in an effort to achieve a normal loan loss ratio, such as that attributed to smaller dollar commercial loans. There are SBA lenders who do not do effective or accurate credit analyses of the loans they recommend. SBA has been reluctant to deal with these lenders who do not use these programs effectively.

Therefore, there are lenders who recommend or grant loans based primarily on the SBA guarantees and do a limited or incomplete credit analysis. If a lender does not play the game right, they must not be permitted to play. SBA should not be renewing the contracts for these lenders. There are many lenders who are effectively serving the small business community, who must not be penalized due to these lenders. Good credit analysis must become a more integral part of the SBA loan process. SBA should utilize their personnel to determine which lenders have the highest loss ratios and then take steps to eliminate these players.

A recommendation to raise PLP guarantee levels has already been made by the Office of Financial Institutions, the SBA's arm which monitors and approves preferred and certified lenders. This proposal would reward the PLP/CLP lender with a higher level of service, emphasizing the concept of treating your best partners in the best manner.

Community bankers who participate as a preferred lender believe these loans should be written with at least an 85- or 90-percent guarantee, depending on the size of the loan. These lenders, the best of SBA, should not be penalized by a lowering of the guaranty. A high guaranty provides an incentive to lenders to perform their best. With the guaranty used as an incentive, SBA delinquencies should be lowered, costs reduced, and processing expedited. In summary, the SBA should be attaching its maximum guaranty to those who earn it.

If a lender does not use the SBA loan program as it is intended, SBA should take steps to improve their performance or terminate that relationship. If SBA is taking unacceptable loan losses, underwriting standards should be tightened. This holds true for both the type of loans being funded and for the lenders with whom SBA does business. If SBA emphasized underwriting standards rather than proposing to reduce guarantees, everyone would win—the Government, the borrower, the lender, and the taxpayer.

A case in point is the Department of Housing and Urban Development's Direct Endorsement Single Family Home Guaranty Program, of which I am one. This program enables qualified lenders to underwrite and close mortgage loans without prior HUD approval. These loans are guaranteed 100 percent by HUD and undergo a cursory after-the-fact review by HUD staff. Participation in this program is a privilege accorded only to mortgagees who continue to demonstrate the ability to originate mortgage loans in accordance with HUD underwriting policy. If review of a lender's underwriting is unsatisfactory, this privilege is reduced or withdrawn.

In the past 2 years, there has been a huge increase in demand for home mortgages due to the lower interest rates. As a result, HUD has placed greater reliance on its best private sector lenders who participate in the direct endorsement program. This has enabled HUD to keep up with the demand with a minimal increase in workload and staffing. Further, Montana's experience in this program, of which we have been a member since 1984, has shown a slightly lower default rate than for those loans approved by HUD's own staff.

As previously stated, Mountain Bank has not had any SBA loan losses in over 13 years. Given this zero percent loss history, of the current 111 outstanding loans totaling $12 million that the Government has guaranteed, SBA has collected fees totaling $120,000. These fees have been collected at the 1-percent level. I am convinced the 1-percent fee can more than adequately cover any loan losses, provided the lender uses the program correctly, has appropriate underwriting guidelines and is given more responsibility.

Lowering the guaranteed percentage will take some lenders out of the market. Banks are simply not organized to take the risk of funding long-term loans by taking short-term deposits. The SBA guaranty is critical in enabling lending institutions to make long-term loans to small businesses. With the present 90-percent guarantee, every $1 million of a bank's capital enables the bank to make $10 million in loans.

In the rural areas of America, this SBA guaranty is critical since it allows small businesses to gain access to long-term capital markets. The Government guarantee helps to provide a more equitable distribution through the country, especially with regard to capital-poor areas such as Whitefish in northwest Montana.

The National Association of Government Guaranteed Lenders has estimated that if the guaranty level is reduced to 80 percent, then for every $1 million in lender capital, only $5 million will be available to small business. With a 75-percent guaranty level, the amount available to small business falls to only $4 million. This points out rather dramatically what even a small reduction in the guaranty level could do to the SBA program.

We have a $12 million guarantee by the SBA in our business today. I would hate to go back and say we cannot make those $6 million in loans which help provide jobs in our community.

Reducing the guaranteed percentage would make these loans significantly riskier and much less attractive to lenders. Lenders will expect to be compensated for taking this additional risk. This will result in a higher cost to the borrowers, most likely in the form of a higher interest rate.

There is no data available which supports the contention that a lower guaranteed percentage will improve the credit quality of these loans. It has been suggested that the SBA policy of increased liquidation responsibility for lenders, like what is presently used in the Preferred Lender Program, is a much greater incentive to making quality loans.

As I stated earlier, SBA should be looking to place greater reliance on their lenders if they want to improve the program. A CLP or PLP lender, by definition, must submit quality applications notwithstanding the guaranty percentage. The SBA should continue to look for quality lenders who participate in the program correctly and eliminate those lenders who are abusing the program.

We do not believe that reduction of the deficit is a very good reason for reducing the guaranty. Last year, the Senate Small Business Committee reported that the net savings from reducing the guaranteed percentage would be a mere $48 million over a 3-year period. It would seem that the loss in tax revenues from small businesses, who would not be able to get an affordable SBA loan, would more than exceed this figure. Furthermore, continued improvement in loan quality should continue to reduce losses from the program.

The administration's budget proposal for SBA is another attempt to make SBA a sacrificial lamb in the budget debate. The Small Business Administration is an excellent Government program that helps to get our Nation's entrepreneurs started and helps keep them going. Certainly there is room for improvement in many of SBA's activities. However, it is a wise investment of public moneys.

Community bankers, like myself, are willing to work toward improving a program that both increases the opportunities of thousands of American small business people and provides job opportunities for millions of Americas. The SBA 7(a) lending program is a program that works. I would like to keep it that way.

Mr. Chairman, I would like to thank you for calling this hearing on this very important small business issue. I would like you to know that the independent bankers are looking forward to working with you and the committee on these issues and pledge our active cooperation.

Chairman LAFALCE. Thank you very much, Mr. Ochenrider for your excellent testimony also.

I am going to defer my questions until the end so that we can proceed. I will try to adhere to the 5-minute rule. Let me just say one thing though, so that no one doubts where I am coming from. As far as I am concerned, with respect to the increase in the guaranty fees, it is unconscionable. If anything, we should reduce the existing fees. And I think it will be difficult to pass any increased fees through this House Small Business Committee. I suspect this might be a very bipartisan perspective.

With that, Mr. Olin.

Mr. OLIN. Thank you very much, Mr. Chairman.

I would like to congratulate the panel for the excellence of the presentations. They have been well prepared, well presented, and the content was very good. I am very pleased that you are unanimous in supporting the continuation of the SBA.

I noted that you are also unanimous on the concept of moving from direct loans to guaranteed loans. There is one category that I am particularly interested in, and I want to ask your reaction.

The largest category of direct loans that remains is the Disaster Loan Program which as you know is partly for small business and partly for homeowners. I have been proposing that we move that to the guaranteed basis because of my experience with disasters where the SBA, operating remotely, has had an awful time exercising good judgment and responding quickly to loan situations resulting from various types of disaster. I think we can save some money with that, too.

I know that the ABA has indicated interest in that. I wondered whether any of the rest of you have comments on the ability of the private sector to respond and the likelihood that we could develop a program that would make sense and move that last category to the guaranteed loan category.

Mr. Sloan.

Mr. SLOAN. Mr. Olin, I am really thrilled to hear you have this interest and in this direction. My experience of 20 years as a banker in observing SBA district offices is that they just are not staffed to, suddenly, overnight, make an enormous volume of loans; therefore, the SBA offices are often getting people to do the loans who do not have the background or the qualifications. These people are basically temporary employees and the result is they make an awful lot of loans that probably should not have been made.

I think that if it could be moved into the guaranteed sector, the quality would improve, the cost to the general taxpayer would be reduced, and we would still accomplish the objective that the Government has of assisting business people who are in trouble.

Mr. OLIN. Thank you very much.

Mr. Rennie, do you have any comments on that?

Mr. RENNIE. I think, in general, I would personally agree with John's comments. Certainly in the disaster loan area having to do with housing, that kind of disaster. The credit worthiness judgments are quite different than, say, looking at a business, and the viability of a loan and that sort of thing. I think we may be faced, often times, with SBA employees trying to make these judgments under pressure and it is very difficult.

I think to be able to use the offices of local banks who know the area and so forth might help a great deal and maybe even speed up the processing. The important thing here is to get rid of these horror stories of people who are not able to get help for one reason or another. And I think by bringing in local banks who have a local interest, it might help a great deal. I think that would be my general reaction.

Mr. OLIN. Mr. Lansaw, have you had any change of heart on this point since I talked to you last?

Mr. LANSAW. Well, Congressman, you and I share a very real concern here since your district was dramatically affected as well as the State of West Virginia. Many areas in which we play an active role were impacted by the flooding in late 1985.

I guess on the one hand I can commend our SBA district office for eventually putting out $50 million as I understand they did in that particular disaster. On the other hand, I share the comments and the anecdotal horror stories. I experienced some of them personally, and I am sure your constituency brought them to your attention rather dramatically.

I think that there is a place for the SBA's involvement in these programs simply because of their experience and organizational ability. However, I do think that it could be supported by private effort. I have indicated, or our committee has indicated to you that we will be happy to try to explore how that can be done. And at this juncture, not committing on behalf of ABA or the Small Business Banking Committee, but on my own behalf, I can assure you that I have had dialogue with our district office and we are trying to attempt to see if there is not something we can come up with in the way of a pilot program or some sort of a mechanism for banking to be involved in a SWAT team concept, if you will, when such an emergency arises.

Mr. OLIN. I will be back in touch with you.

Mr. Garrett, do you have any comment?

Mr. GARRETT. Nothing to add to what the other people have said, other than I think it is an excellent idea that the private sector work with SBA to improve the situation.

Mr. OLIN. Mr. Ochenrider from the independent bankers, any comments?

Mr. **Ochenrider**. As an independent banker, sir, I do not have any real experience in that area. As a community banker in Whitefish, we have seen quite a few disaster loans over in eastern Montana in the farm area, and quite a few of them have helped out. I can see where some more local involvement would help because although we are up in Montana, all the loans, disaster loans are approved in Sacramento, CA, and so, that takes quite a lot of time. I would like to see some more local control at banks.

Mr. **Olin**. All right. Thank you very much, gentlemen.

Thank you, Mr. Chairman.

Chairman **LaFalce**. Thank you very much, Mr. Olin.

Gentlemen, we have an extremely important vote taking place right now. The question is whether we should approve the journal of yesterday, and I know we all want to make it. So the Small Business Committee will be in recess for approximately 10 minutes or so.

[Recess.]

Chairman **LaFalce**. The Committee on Small Business will reconvene.

Mr. Ireland.

Mr. **Ireland**. Thank you, Mr. Chairman. Being very interested in the 7(a) program, I could not help but be enthusiastic about the panel here this morning. There is an acknowledgement that the capital markets of this country, on the one hand, are substantial, yet, on the other hand, have a difficult time getting those funds to small business despite the 7(a) program and the very strong efforts of the banking fraternity of which Mr. Sloan and I were members.

We need to do something about it. The something about it is not necessarily raising fees and threatening the folks at the SBA. I welcome those that are serious about doing something about it to join me in exploring ideas about privatizing the 7(a) program. The point was made that our banking industry is in the short-term liability acquisition business, and under our laws has little reason to be in the long-term asset business. Somehow this escapes policymakers in this country. Until we solve that very real problem, we are not going to get much done.

Allow me to run two numbers of our banking witnesses. One has a $400 million bank, and the other has a $32 million bank. The one with the $32 million bank obviously is using the secondary market. It has $12 million in guaranteed loans and the one with the $400 million bank has $8 million of guarantee loans.

Mr. Lansaw, could you indicate to us why we are not making so many long-term loans for small business whether they are guaranteed or otherwise.

Mr. **Lansaw**. Well, Congressman, I think that it is a function of the fact that while SBA guaranteed lending at our particular institution is very important, it is not a large part of our loan portfolio in terms of the relative size of our overall portfolio. It is a significant portion of our business loan portfolio.

It is conceivable that we put a——

Mr. **Ireland**. Could you put a percentage on that for me?

Mr. **Lansaw** [continuing]. Of our business loan portfolio, it would represent less than 10 percent; somewhere in the 8-percent range in terms of dollars.

Mr. **Ireland**. Thank you.

As a percentage, could you tell us what portion of your loan portfolio you classify as long-term loans?

Mr. **Lansaw**. That would be a little more difficult for me, but we do have a mortgage loan portfolio, some $40 million. I would say we might be talking about—are you talking about business loans or the entire loan portfolio?

Mr. **Ireland**. Business loans, yes.

Mr. **Lansaw**. Not more than 10 or 15 percent.

Mr. **Ireland**. What I am driving at is, all of us need to understand that our banks are not in the long-term lending business. And until we recognize that from a policy standpoint and stop beating up on the banks and stop beating up on the SBA and do something about it with a privatized, Government-sponsored entity to make up for the Government-sponsored market imperfection, we are not going to have you and Mr. Garrett and some of the others tapping that market of capital funds.

Mr. **Lansaw**. There is no question that of the average maturity of business loans in our portfolio, that the SBA portfolio compared to the rest of our business-loan portfolio has a much longer maturity, and I have been fortunate enough to work on some industry, commercial banking industry studies that bear that out throughout the industry.

Mr. **Ireland**. Mr. Rennie, you mentioned something dear to my heart, and that is international trade and export business. Any specific ideas of what ought to be done?

Mr. **Rennie**. I think probably a lot of the ideas that I would have as a starting point were probably embodied in the report from the National Commission on Jobs and Small Business, of which I was a commissioner. I had a lot to do with the international trade part of that report.

Basically, whenever you go around the country, and I have been involved in trying to promote small business exports now, probably, since 1977, I guess in one form or another, when I discovered it myself and realized the potential, it always comes down to four basic areas.

The first is incentives. Most of our small businesses start on a domestic market premise and they seldom have the domestic market saturated. So the decision of a small business owner in this country relative to trade, in getting into international trade is different than a business owner in Germany or France where they normally start with a multinational premise. Here the owner has to decide should I expand to Western Europe or should I expand to Arizona. And guess what, Arizona wins most of the time.

The fact is we do not have any real incentives in this country to move that decision to favor trade, to get involved in trade.

The second area is education in the broadest sense. Educating the small business people about the procedures of trade, to dispel some, what they perceive as barriers that really are not, to sharpen up what really are barriers, and also to get involved with the area of helping them in the procedures involved.

The third area is the flow of marketing information. We simply do not have timely ways of moving requirements from potential overseas buyers to the U.S. small business community, and that is an area where we made some suggestions.

And finally, the examination of imports has been examined much more thoroughly in the past 3 or 4 years. This examination is not in a protective mode, but rather looking at the import quotas we have on the books and examining them. If they are real and they are worthwhile and they are just, then they should be enforced. If they are not, they should be eliminated, and we should then put added importance and focus on the assistance programs that are available but are not widely known in the small business community for U.S. businesses that are adversely affected by imports in their industry.

I would start with those four areas, and then under those we did advance in the report, some specific suggestions that probably we do not have time to go into now. But that is how I would generally approach it.

Mr. IRELAND. Thank you very much.

Chairman LAFALCE. Ms. Meyers, do you have any questions you wish to ask of this panel?

Ms. MEYERS. I will pass at this time.

Chairman LAFALCE. Thank you very much.

Counsel Tom Powers had some questions I think he wanted to ask Mr. Garrett, with respect to the methodology and arriving at a 25-percent or 18-percent gross profit margin.

Mr. POWERS. In your testimony, you cited the impact of reducing your gross profitability if we were to reduce the guaranty percentage. Can you briefly run through, for us, how you arrive at your current percentage computation of gross profit on an SBA guaranteed loan, and I presume this is through sale in the secondary market, and how you are able to get a multiplier effect?

Mr. GARRETT. Yes; basically what I did is I made some assumptions, a $100,000 loan for simplicity, prime plus 2 is the rate; selling it in the secondary market for, let us say, 104, so there is a 4-point premium; and that the lender gets a 1.5-percent servicing fee.

So when I ran those numbers, and you take the premium, let us say on a $100,000 loan, you have a $4,000 premium when you sell it, assuming it was a 7-year loan and amortizing that premium over 7 years. So you get $4,000 when you sell it, but you have got to recognize that income over the life of the loan is how I arrived at the actual number of 27–28 percent.

I mean I can go through the math for you, but that was the assumption that I used.

Chairman LAFALCE. Would you flush that out in writing so we could see precisely how you did arrive at that?

Mr. GARRETT. Sure, I would be glad to.

Chairman LAFALCE. Mr. Mfume, do you have any questions you would like to ask of this panel?

Mr. MFUME. Not at this time.

Chairman LAFALCE. All right, thank you.

Well, then, gentlemen, I want to thank you very much for your excellent presentation. It will be of tremendous assistance to this committee as we deliberate the recommendations of the Small Business Administration. Thank you very much.

Will the next panelists please come to the table?

Our next panel will be devoted to the subject of venture capital, and we are pleased to have before us Mr. Peter McNeish, formerly of the SBA, and now of NASBIC. You, Mr. McNeish, will be our first witness and please proceed.

Mr. **McNeish**. I wonder if my colleague might go first if it does not make any difference to you.

Chairman **LaFalce**. Oh, fine. Our next witness will be Mr. John E. Oxendine, president of Broadcast Capital, Inc., on behalf of the National Association of Investment Companies which is the new name. What was the old name?

Mr. **Oxendine**. The American Association of MESBIC's, Minority Enterprise——

Chairman **LaFalce**. That is what I thought. It is going to take me time, whenever I see NAIC now, to come to recognize your group as there is also another NAIC, also the National Association of Insurance Commissioners. That is going to confuse the heck out of me, particularly as I introduce my bill repealing the McCarran-Ferguson Act and NAIC keeps opposing it. You will not oppose me, will you?

Mr. **Oxendine**. No.

Chairman **LaFalce**. OK, thank you.

OK, please proceed, Mr. Oxendine.

Mr. **Oxendine**. OK.

TESTIMONY OF JOHN E. OXENDINE, PRESIDENT, BROADCAST CAPITAL, INC., REPRESENTING NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

Mr. **Oxendine**. Good morning, Mr. Chairman, and members of the House Small Business Committee. My name is John Oxendine, and I am president of Broadcast Capital, Inc. Today, I am representing the National Association of Investment Companies because I am a member of their legislative committee, and I am happy to have the opportunity to appear here today to testify on our thoughts on the fiscal 1988 budget proposal.

Just by way of background, Broadcast Capital, Inc., is a small venture capital company.

Chairman **LaFalce**. Let me just interrupt you, Mr. Oxendine, for one thing.

Mr. **Oxendine**. Sure.

Chairman **LaFalce**. I noticed that your testimony is 11 pages, and I would really like for both you and Mr. McNeish to try to summarize your remarks within 5 to a maximum of 10 minutes, because the members of the committee do have to get to some other——

Mr. **Oxendine**. OK, fair.

I will not tell all the great success stories. You can read them in the testimony.

But, just by way of background, my company is a small company funded by the broadcast industry. We have about $10 million of private paid-in capital.

It is important to realize that our industry represents about 150 miniority small business investment companies that we have invested this last year about $145 million, and that represents approximately 1,500 small businesses that we invested in. Those investments generated approximately 19,000 jobs, and those jobs and that income generated approximately $140 million in taxes to the Government. So, we have been significant players.

When we look at what the SBA has provided us in the past, last year they gave us $39 million. That $39 million allowed us to generate $145 million in investments, and that in turn generated almost $300 million in other private sector investments. So that almost $40 million from the SBA was able to be turned over 11 times to about $435 million in minority small business investments. So we think that this was a very effective program.

The administration proposes that our budget be cut from $39 million to approximately $20 million. They want to cut our funding in half. Now they suggest that they are going to substitute $14 million in guarantees through the Small Business Funding Corporation.

Well, I would like to say that when we review the MESBIC Program there are some things that are very critical to the program. As you know, we get our funding from preferred stock and debentures, which are more costly. What the administration is proposing is that they eliminate our relatively inexpensive funds, our preferred stock. That $19 million would be taken away from us.

And that is significant because in small business you need that seed capital. You need that equity capital for the kinds of loans we have to make, and that would be taken away from us. So we have a real serious problem with that.

The administration wants to substitute $14 million in guarantees through the Small Business Funding Corp., and we think that that is not acceptable simply because we take a relatively inexpensive, patient product, $19 million. We substitute a product we do not think offers the same benefits, that is, a guarantee for $14 million. We have taken a direct cut of $5 million right there. And this $14 million guarantee, we do not think is terribly effective for us because what they are saying is we are not going to give you the exact dollars. What we are going to do is we are going to put your money in the Small Business Funding Corp. and we are going to put the MESBIC's there. So we are going to have to go through that financing vehicle.

That is a problem because we have lost the use of 3-percent money, and we exchange it for money that costs about 10 percent. The offerings that the funding corporation put out last year came out at about 7.95 percent, or about 8 percent. On top of that they are adding a guaranty fee of 1 percent, and then there is 80 basis points for usage. So we are talking about 10 percent money.

We would have to believe that the funding corporation going to the market is going to have to have a business screen and some of our MESBIC's may be screened out of the situation. So when we look at the administration's proposal, we lose $19 million, which is patient, lower-cost money, and we substitute it for guarantee money.

And when you take our cash and give us guarantees, it gives it a different perception to the community. So it is a perception problem, and it is an actual problem in terms that it eliminates half our budget. But if, in fact, the $14 million worked, we think that in the process of the funding corporation going to market, it might screen out a lot of us, and MESBIC's would be lost and the application process might be problematic because it is a guarantee program and would make it difficult for us to get our money.

Right now at the funding level we are at, we are looking at 6-month backlogs in terms of applications, leverage backlogs from our 150 companies. That would probably double to a year. So we have some very serious problems with this proposal to go from 19 to 14, and this 14 then is really guarantees and the guarantees are more expensive. It does not make a whole lot of sense.

Again, talking about the guarantee. Not only do they want us to take our cash and substitute guarantees, but then the guarantees they want to reduce from 100 percent to 90 percent in the funding corporation. And that again adds a little bit more insult to what is going on.

We think that in effect the Government is having a program by program breakdown of the MESBIC industry. We think that in theory it makes a whole lot of sense to them, but to us in practice it is going to cause the demise of our industry.

You take our organization, for example, Broadcast, we have had a return on investment of about 12.7 percent, which has been better than the entire industry. The preferred stock was significant to us because it allows us to provide seed capital to our portfolio companies. It allows us to be able to function in a way so operating expenses are not that much, so we have a little bit of spread for ourselves. And it allows us to be patient with the kinds of companies we have to deal with.

The substitute that is being offered will make us more like straight bankers, and therefore we are not going to be able to lend to the same kinds of people we are lending to. So there are some significant cuts across the board.

We will not be able to operate effectively as small business investment companies. The communities that we deal with will not be able to be funded properly, and those that are left once they are screened out by the business screen of the funding corporation might be few.

We have some serious problems with the preferred stock situation and we have some serious problems with the guarantee, and we are not happy about having our funds cut in half.

[Mr. Oxendine's prepared statement follows:]

Prepared Statement of John E. Oxendine, President, Broadcast Capital, Inc., Representing National Association of Investment Companies

Good morning Mr. Chairman and members of the House Small Business Committee. I am John Oxendine, President of Broadcast Capital, Inc., in Washington, D.C. and member of the Legislative Committee of the National Association of Investment Companies (NAIC). I am pleased to have the opportunity to appear before the Committee today as it hears testimony on the Administration's fiscal year 1988 budget proposal.

Broadcast Capital, Inc., or BROADCAP, was established in 1978 as the product of the Task Force on Minority Ownership that was sponsored by the National Association of Broadcasters. The Association's support has led to the creation of a unique broadcast industry partnership to lessen the acute underrepresentation of minorities among the owners of broadcast businesses and increase meaningful employment opportunities for minorities in the broadcast industry. BROADCAP was initially funded by voluntary contributions of cash and corporate guarantees from the networks and members of the broadcast industry.

As a member of the NAIC Legislative Committee, I am here today representing an industry of approximately 150 investment companies. Last year, our companies invested $145 million in 1,440 minority owned small businesses. In addition to supporting minority entrepreneurship, those investments helped to create or maintain an estimated 18,720 jobs and generate estimated government tax collections of almost $140 million. Although these numbers by themselves are impressive, they become even more so

WHEN THE "MULTIPLIER EFFECT" OF OUR INVESTMENTS IS CONSIDERED. USING LAST YEAR AS AN EXAMPLE, THE SBA PROVIDED $39 MILLION IN LEVERAGE TO MESBICS. MESBICS, IN TURN, INVESTED $145 MILLION IN MINORITY OWNED SMALL BUSINESSES. THIS $145 MILLION IN MESBIC MONEY IS ESTIMATED TO HAVE ATTRACTED AN ADDITIONAL $290 MILLION INTO MINORITY BUSINESSES FROM OTHER PRIVATE SECTOR SOURCES. THESE SOURCES WERE ONLY WILLING TO PROVIDE THE CAPITAL, HOWEVER, AFTER MESBICS HAD TAKEN THE POSITION OF FIRST RISK. THE TOTAL INVESTMENT IN THE MINORITY SMALL BUSINESS COMMUNITY AS A RESULT OF THE GOVERNMENT'S $39 MILLION LEVERAGE TO MESBICS LAST YEAR WAS THUS $435 MILLION, PROVIDING AN IMPRESSIVE COST-BENEFIT RATIO OF 1 TO 11. IN SIMPLER TERMS, FOR EVERY DOLLAR THE GOVERNMENT INVESTS IN THE MESBIC INDUSTRY, ELEVEN DOLLARS IS INVESTED IN THE MINORITY SMALL BUSINESS COMMUNITY.

WHEN THE MESBIC PROGRAM WAS ESTABLISHED, THE LEVERAGE SYSTEM WAS SET UP SO THE SMALL BUSINESS ADMINISTRATION COULD OFFER MATCHING FUNDS TO MESBICS IN TWO VERY DISTINCT FORMS. EACH OF THE FORMS WAS DESIGNED WITH A PARTICULAR PURPOSE IN MIND. THE FIRST FORM ALLOWS THE SBA TO PURCHASE 3% CUMMULATIVE PREFERRED STOCK IN A MESBIC. PREFERRED STOCK LEVERAGE IS USUALLY THE FIRST TYPE OF LEVERAGE OBTAINED BY A MESBIC, BECAUSE IT FREES THE INVESTMENT COMPANY FROM HEAVY DEBT SERVICE OBLIGATIONS AS IT IS SETTING UP ITS PORTFOLIO AND WAITING FOR THE INVESTMENTS TO BEGIN TO GENERATE A CASH FLOW. THE AVAILABILITY OF PREFERRED STOCK LEVERAGE IS PARTICULARLY IMPORTANT BECAUSE IT ALLOWS MESBICS TO MAKE EQUITY INVESTMENTS IN MINORITY SMALL BUSINESSES THAT THEY COULD NOT MAKE IF THEY WERE CONCERNED WITH COVERING THEIR DEBT

SERVICE. THE SECOND TYPE OF MESBIC LEVERAGE IS SUBSIDIZED DEBENTURES. THE SBA PURCHASES TEN YEAR DEBENTURES FROM MESBICs. THESE DEBENTURES CARRY AN INTEREST RATE EQUAL TO THE FEDERAL FINANCING BANK RATE, WITH A 3% INTEREST RATE SUBSIDY FOR THE FIRST FIVE YEARS OF THE DEBENTURE. DEBENTURES ARE TYPICALLY TAKEN DOWN BY MESBICs THAT ALREADY HAVE AT LEAST ONE TIER OF PREFERRED AND HAVE BEGUN TO GENERATE A CASH FLOW THAT CAN BE USED TO COVER DEBT SERVICING. THE SECOND TIER OF PREFERRED STOCK LEVERAGE IS AVAILABLE ONLY TO THOSE COMPANIES THAT HAVE PROVEN RECORDS OF PROVIDING EQUITY CAPITAL, UNSECURED SUBORDINATED DEBT, OR SIMILAR FORMS OF FUNDING THAT TYPICALLY CARRY WITH THEM A HIGHER LEVEL OF RISK, BUT ARE LESS BURDENSOME ON THE MINORITY ENTREPRENEURS.

ALTHOUGH FORMS OF MESBIC LEVERAGE HAVE REMAINED THE SAME, MANY OTHER THINGS HAVE CHANGED THROUGHOUT THE YEARS. WHEN THE PROGRAM WAS FIRST ESTABLISHED, THE MINIMUM PRIVATE CAPITAL REQUIREMENT FOR STARTING A MESBIC WAS $250,000. THAT FIGURE HAS NOW RISEN TO ONE MILLION DOLLARS IN RECOGNITION OF THE NEED FOR A SUBSTANTIAL CAPITAL BASE TO SUCCESSFULLY COVER THE COSTS OF RUNNING AN INVESTMENT COMPANY. FOR MANY YEARS, MESBICs AUTOMATICALLY RECEIVED THEIR FIRST TIER OF PREFERRED STOCK LEVERAGE. THEY NOW MUST INVEST AT LEAST 65% OF THEIR PRIVATE CAPITAL BEFORE THEY BECOME ELIGIBLE. QUALIFICATIONS FOR MESBIC INVESTMENT ADVISORS HAVE BECOME MUCH STRICTER AND HAVE RESULTED IN MUCH MORE SOPHISTICATED INVESTORS AND INVESTMENTS. ALL OF THESE CHANGES HAVE HELPED TO IMPROVE THE INDUSTRY OVER THE YEARS. IN A SENSE, THEY HAVE BEEN GRADUAL MOVES TOWARD MAKING THE INDUSTRY MORE SUCCESS-

FUL AND SELF-SUSTAINING. WE HAVE WELCOMED THESE IMPROVEMENTS, AND I CAN ASSURE YOU THAT NO ONE WANTS THE PROGRAM TO BE MORE SUCCESSFUL AND EVENTUALLY SELF-SUSTAINING THAN WE DO.

THE ADMINISTRATION HAS OFFERED A BUDGET PROPOSAL THIS YEAR THAT SUPPOSEDLY WILL HELP MESBICs TO ACHIEVE THESE GOALS. IN REALITY, HOWEVER, THE PROPOSAL WOULD LEAD TO THE INDUSTRY'S DEMISE. THE ADMINISTRATION PROPOSES TO DECREASE DIRECT FUNDING FOR MESBICs FROM ITS FISCAL YEAR 1987 LEVEL OF $39 MILLION TO JUST $20 MILLION. THE $19 MILLION DECREASE REPRESENTS THEIR PLAN TO ELIMINATE PREFERRED STOCK LEVERAGE TO MESBICs. IN PLACE OF THE PREFERRED STOCK LEVERAGE, THEY PROPOSE TO MAKE AVAILABLE $14 MILLION IN GUARANTEED FUNDING TO ALLOW MESBICs TO OBTAIN FUNDS THROUGH THE SBIC FUNDING CORP. EVEN SBA ACTING ADMINISTRATOR CHARLES HEATHERLY, IN HIS COMMENTS BEFORE THE SENATE SMALL BUSINESS COMMITTEE ON FEBRUARY 24, CLAIMED THAT THE ADMINISTRATION'S PROPOSAL HAD CUT BACK MUCH MORE ON THE MESBIC PROGRAM THAN HE HAD EXPECTED.

THE FEASIBILITY OF THE ADMINISTRATION'S PROPOSAL WITH RESPECT TO MESBICs IS QUESTIONABLE FOR SEVERAL REASONS. FIRST, THE AVAILABILITY OF PREFERRED STOCK LEVERAGE IS ABSOLUTELY ESSENTIAL TO THE MESBIC INDUSTRY. OUR PROGRAM WAS SET UP TO MAKE LONG TERM, PATIENT EQUITY CAPITAL AVAILABLE TO THE MINORITY SMALL BUSINESS COMMUNITY. OUR RESTRICTED INVESTMENT POLICY CARRIES WITH IT AN INHERENTLY HIGH LEVEL OF RISK. ASKING US TO INCREASE THAT RISK BY ACCEPTING DEBT SERVICE OBLIGATIONS ON ALL OUR MONEY WHILE CONTINUING TO MAKE EQUITY INVESTMENTS MAKES OUR JOB

IMPOSSIBLE. RESPONSIBLE PORTFOLIO MANAGEMENT DICTATES THAT IF WE MUST COMMIT TO MAKING REGULAR INTEREST PAYMENTS TO OBTAIN OUR MONEY, WE MUST ALSO CHARGE SMALL BUSINESSES REGULAR INTEREST PAYMENTS TO COVER OUR COSTS. IN OTHER WORDS, WE ARE FORCED TO BECOME STRAIGHT LENDERS. THAT WAS NOT THE ORIGINAL PURPOSE OF THE MESBIC PROGRAM, AND I DON'T BELIEVE YOU WANT IT TO BECOME OUR PURPOSE NOW. THE MINORITY SMALL BUSINESS COMMUNITY NEEDS THE EQUITY FINANCING WE ARE ABLE TO PROVIDE THROUGH THE AVAILABILITY OF PREFERRED STOCK LEVERAGE.

SECOND, THE PROPOSED MESBIC GUARANTEE PROGRAM IN NO WAY SUBSTITUTES FOR PREFERRED STOCK LEVERAGE. IT WOULD MAKE FUNDS FOR MESBICS SIGNIFICANTLY MORE EXPENSIVE, AND THERE IS NO GUARANTEE THAT THE FUNDS WOULD BE MADE AVAILABLE. IN ITS PROPOSAL, THE ADMINISTRATION APPEARS TO ASSUME THAT THE SBIC FUNDING CORP. HAS ACCESS TO UNLIMITED FUNDS. THIS ASSUMPTION IGNORES THE ELEMENT OF RISK IN THE PROFILES OF MESBICS AND SBICS. UNDER OUR PRESENT FUNDING SYSTEM, WE RECEIVE $39 MILLION IN DIRECT FUNDING IN THE BUDGET, AND WE KNOW THAT FULL $39 MILLION WILL BE AVAILABLE. ON THE OTHER HAND, SBIC ACCESS TO FUNDS HAS FALLEN OFF SIGNIFICANTLY SINCE THEY MOVED INTO THE SBIC FUNDING CORP. ALTHOUGH PART OF THE REASON FOR THIS MAY BE DUE TO START-UP CONSIDERATIONS, PART OF IT UNDOUBTEDLY CAN BE ATTRIBUTED TO A WEEDING-OUT PROCESS TO MAKE THE CORPORATION'S OFFERING MORE ATTRACTIVE TO THE MARKET. GIVEN THE FACT THAT MESBICS TEND TO BE LESS HEAVILY CAPITALIZED THAN SBICS, THEY DON'T INVEST IN GENERAL MARKET COMPANIES, AND THEIR INHERENT LEVEL OF RISK IS HIGHER, WE ARE UNDERSTANDABLY CONCERNED THAT THE MAJORITY OF MESBICS WOULD BE "WEEDED OUT" OF THE CORPORATION'S OFFERINGS.

The mechanics of this fusion of MESBICs into the SBIC Funding Corp. are also unclear. Although we have tried to get more details on how the proposal would work, they do not seem to be available. The Administration wants to lower the SBIC guarantee level from 100% to 90%. Will this apply to MESBICs too? Will they have different standards for participating in offerings? What will happen to MESBICs that joined the industry assuming the availability of preferred stock leverage, but who have not yet had the opportunity to obtain that leverage?

Even if we assume MESBICs will have access to $14 million in funding through the SBIC Funding Corp., these high cost funds hardly can be considered a suitable replacement for our relatively low-cost preferred stock leverage. In the Corporation's last offering, it paid 80 basis points over comparable Treasury rates, or 7.95%. The Administration is proposing an additional 1% guaranty fee on SBIC guaranty approvals, and to decrease the guarantee level from 100% to 90%. Each of these proposals will increase the cost of funds to investment companies. Introducing the higher risk MESBIC portfolios into the Corporation's offerings promises to drive up the cost of funds even higher. The Administration is offering to replace 3% preferred leverage with debt obligations that would appear to cost around 10%. By no stretch of the imagnation could this proposal be considered a suitable replacement.

Finally, even if we were to go so far as to assume the proposed MESBIC guarantee program would work and that MESBICs

COULD AFFORD TO USE IT, THE COMBINED DIRECT GUARANTEED FUNDS OF $34 MILLION ARE GROSSLY INSUFFICIENT TO SUSTAIN THE INDUSTRY. IN 1982, THE MESBIC INDUSTRY RECEIVED $46 MILLION IN LEVERAGE. EVEN AT THAT LEVEL, FUNDING WAS INSUFFICIENT TO SERVICE ALL THE LEVERAGE APPLICATIONS. SINCE THEN, MESBIC FUNDING HAS STEADILY DECREASED TO ITS PRESENT LEVEL OF $39 MILLION. AFTER SEVERAL YEARS OF INSUFFICIENT FUNDING, WE HAVE A LEVERAGE APPLICATION BACKLOG OF ABOUT SIX MONTHS. DECREASING OUR FUNDING BY $5 MILLION, OR 13%, WILL EXACERBATE THAT BACKLOG PROBLEM. IF WE DROP OUR ASSUMPTION THAT THE MESBIC GUARANTEE PROGRAM WILL WORK, HOWEVER, MESBIC FUNDING WILL BE CUT IN HALF. THIS CUT WOULD PRODUCE A STRANGLING LEVERAGE BACKLOG THAT WOULD FORCE MANY MESBICs - AND THE COMPANIES THEY FINANCE - OUT OF BUSINESS.

LOOKING BEYOND THE ADMINISTRATIONS BUDGET PROPOSAL ITSELF, I AM INCLINED TO QUESTION ITS INTENDED PURPOSE. MOST BUDGET PROPOSALS ARE AIMED AT BUDGET CUTS. THIS PROPOSAL, HOWEVER, PRODUCES VERY LITTLE IN BUDGET SAVINGS WHILE SIGNIFICANTLY DISRUPTING THE PROGRAM'S STRUCTURE. WHY DOES THE ADMINISTRATION WANT TO ELIMINATE PREFERRED STOCK LEVERAGE? THE ANSWER WOULD APPEAR TO BE A PHILOSOPHICAL - RATHER THAN BUDGET CUTTING -MOTIVE. IT WOULD SEEM THAT EITHER THE ADMINISTRATION HAS DECIDED IT NO LONGER WANTS TO PROMOTE EQUITY INVESTMENTS IN THE MINORITY SMALL BUSINESS COMMUNITY, OR THAT IT NO LONGER WANTS TO DO SO THROUGH ITS OWN EQUITY INVESTMENTS. OPTIMISTICALLY, I WILL ASSUME THE LATTER TO BE THE CASE.

DURING THE DISCUSSION LAST YEAR CONCERNING LEGISLATION TO CREATE THE CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI), THE

Administration is said to have referred to MESBIC preferred stock as a grant. I would like to take this opportunity to dispel that myth. Every company with preferred stock leverage is obligated to pay accumulated dividends to the SBA before any distribution can be made to its other shareholders. No private investor can make a profit from a MESBIC until the government is paid - preferred stock has a prior claim over ALL the private sector investments. By suggesting the preferred stock leverage is a grant, the Administration is saying that all the common stock investments in MESBICs are even less than grants. The private sector has invested over $170 million in the MESBIC industry. I can assure you that $170 million investment was not made on the assumption that the funds would be a grant. That $170 million investment was made because of a belief that there is money to be made in investing in the minority small business community.

As an example of one of our successful investments, I would like to cite a turn-around deal BROADCAP did here in the Washington area. Howard Sanders, chief executive of Howard Sanders Communications Corporation, transformed WYCB-AM in Washington from a "love, peace, and message music" station with less than $4,000 in advertising and half a million in debt into the country's first 24-hour gospel and inspirational music format in the country. We provided a $250,000 commitment in an eight year subordinated debenture in Howard Sanders' purchase of WYCB-AM. Gross monthly billings now exceed $75,000 and WYCB-AM is the number one station of its kind in the market with an audience of 80,000 households every 15 minutes in the Washington, D.C. area.

XINIX, Inc., a Santa Clara semiconductor instrumentation company, received $900,000 in third round equity financing from two MESBICs and other investors. The Chinese American company, founded by Dr. Larry Lu and operating with a team of eight Ph.D. Chinese American scientists, designed, develops and manufactures Dry Etching Endpoint Controller and Quartz Crystal Monitor controlling processes used in manufacturing semiconductor and thin film devices. Although the company is at the difficult expansion stage, XINIX has doubled its sales each year for the past three years, and recently received orders from IBM.

Systems Management American Corporation -- number 9 on Black Enterprise's "Top 100" Black Businesses list -- had 40 employees and sales of $500,000 annually in 1975 when Norfolk Investment Company, a Virginia-based MESBIC, decided to take a risk with the computer software and hardware company. The MESBIC's equity interest was bought out by the entrepreneur, and all debt was retired by 1984. Today, SMA's 600 employees operate in offices in the Norfolk, Virginia headquarters, Washington, D.C., San Diego, Hawaii and Germany. SMA sales have increased to over $30 million annually.

Several MESBICs have provided first and second round financing to VST Labs, a Michigan-based machine vision company that manufactures a high resolution camera for use in industrial operations. The company has the leading optics expert in the Midwest, and the product has such high resolution it can be used to detect small bones in sealed soup cans. In addition to

PROVIDING FINANCING, THE INVESTORS ARE CURRENTLY WORKING WITH VST LABS TO PRODUCE AN AGGRESSIVE MARKETING PROGRAM. IT IS OFTEN THE CASE, IN FACT, THAT MESBIC INVESTORS PROVIDE MANAGEMENT, MARKETING AND OTHER TECHNICAL ASSISTANCE TO COMPANIES IN ADDITION TO FUNDING THEM.

THESE MESBIC INVESTMENTS SHOW THAT WE ALREADY HAVE MADE SIGNIFICANT CONTRIBUTIONS TO THE MINORITY SMALL BUSINESS COMMUNITY, THAT OUR CURRENT INVESTMENTS PROMISE TO CONTINUE TO DO SO IN THE FUTURE, AND THAT WE HELP TO PROVIDE MUCH - NEEDED EMPLOYMENT AND MANAGEMENT TRAINING OPPORTUNITIES TO MINORITIES. IN ORDER TO CONTINUE TO DO SO, HOWEVER, WE NEED CONTINUED FUNDING STABILITY, WITH PREFERRED STOCK LEVERAGE AS PART OF THAT FUNDING.

IN SUMMARY, I URGE YOU TO RECOGNIZE THE ADMINISTRATION'S BUDGET PROPOSAL FOR WHAT IT IS -- A PROPOSAL THAT VIRTUALLY ELIMINATES THE MESBIC PROGRAM. THIS IS CONSISTENT WITH THEIR PROPOSALS OVER THE PAST FEW YEARS, AS THEY HAVE TRIED TO ELIMINATE US ALONG WITH THE ENTIRE SMALL BUSINESS ADMINISTRATION. THEY APPARENTLY HAVE CHANGED THEIR STRATEGY TO A PROGRAM - BY - PROGRAM ATTACK, BUT THE END RESULT IS STILL THE SAME FOR US, AND FOR THE MINORITY SMALL BUSINESS COMMUNITY WE SERVE.

BY ELIMINATING OUR PREFERRED STOCK LEVERAGE, THEY INHIBIT OUR ABILITY TO MAKE LONG TERM PATIENT EQUITY CAPITAL AVAILABLE TO MINORITY SMALL BUSINESSES. BY REPLACING OUR LOWER COST PREFERRED STOCK LEVERAGE WITH HIGH COST SBIC FUNDING CORP. LEVERAGE, THEY FORCE US TO CHARGE RATES ON OUR MONEY THAT ONLY A FEW MINORITY

BUSINESSES WOULD BE WILLING OR ABLE TO PAY. AND BY DECREASING OUR FUNDS BY AS MUCH AS ONE-HALF THE PREVIOUS LEVEL, THEY CREATE A LEVERAGE APPLICATION BACKLOG THAT WILL FORCE MANY MESBICS OUT OF BUSINESS. I URGE THE MEMBERS OF THE SMALL BUSINESS COMMITTEE TO OPPOSE THE ADMINISTRATION'S BUDGET PROPOSAL.

THANK YOU FOR THIS OPPORTUNITY TO APPEAR BEFORE YOU TODAY. I WOULD BE HAPPY TO ANSWER ANY OF YOUR QUESTIONS.

Chairman LaFalce. Thank you very much, Mr. Oxendine.

Our next witness will be Mr. Peter F. McNeish.

TESTIMONY OF PETER F. McNEISH, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES [NASBIC]

Mr. McNeish. Thank you, Mr. Chairman, members of the committee. It is a privilege for me to be, I believe, your last witness of these hearings. It may be a pleasure for you to have your last witness here as well. I will be brief.

First, Mr. Chairman, our directors, officers, and membership offer you our congratulations on your selection as chairman of the committee.

I have submitted written testimony for the record and I will not read that. I will try to convey some of the major points and make a few observations, diverting somewhat from the written testimony. I have addressed several specific objections to things like the additional fees and reduced guarantee percentage levels; not so dissimilar in theory and concept from what the previous panel had discussed.

It is clear the SBIC industry has a vested interest in the administration's proposals for the SBIC portion of SBA's budget, and my testimony in that vein is quite predictable. Let me give you a very ineloquent summary of our view. We think it stinks.

We support the National Association of Investment Companies' position that the budget proposals would effectively produce serious injury to the MESBIC Program, and we think the committee should scrap those efforts immediately.

I have reviewed these documents, Mr. Chairman, in some depth, and I thought the first time I might have missed something, so I went back and reread it all again. And, Mr. Chairman, let me tell you that I would characterize this as a 2-pound cow pie, and the committee should bag it quickly before it smells up the committee hearing room.

Chairman LaFalce. Let the record indicate that it is my belief that Mr. McNeish is referring to the statement and documentation submitted by Mr. Heatherly before this committee; is that correct?

Mr. McNeish. That is correct.

Chairman LaFalce. It was not Mr. McNeish's prepared testimony.

[Laughter.]

Mr. McNeish. I appreciate your clearing that up. I meant to say the SBA documents your staff sent to me. I appreciate that.

Mr. Chairman, as you know, entrepreneurs are inherently very optimistic. And the people who represent them, trade associations and others, share that kind of optimism. We had hoped that once the administration made the political decision to retain an independent SBA that they would get on with the business of making SBA a model of entrepreneurship in and of itself, making SBA the focal point for Government's commitment to small business, making SBA a launching pad for creative new ideas of how small business could help restore America's international competitive edge, and making SBA an outstanding example of how a small Government agency could creatively leverage private resources to produce enormous public benefit.

It is pretty clear we were wrong in that hope, and the SBIC Program is a good case in point. For a number of reasons, some of which were explained by the previous panel, involving risk, the structure of our capital markets, economies of scale, and other factors, small business simply does not have adequate access to long-term capital markets.

The SBIC Program has a proven track record of success in this field, financing small business and producing a profit, if you will, for the Government. So the optimist would say if the Government's policy is to support small business, the right thing to do is to see how we can improve the program, expand the program, build on the success of the private/public partnership involved in the program, and help in retooling the program by way of COSBI, so the program works better than it has in the past.

Does that sound right? Wrong! What we got from the administration under the rubric of self-sufficiency, risk reduction, and budget deficits is additional up front costs, guarantee fees, increased user fees, reduced guarantees, and proposed legislative restrictions; all designed to make the program so costly and so unattractive that it makes no sense for the private sector to participate. Private investors would be driven out and the program would in effect be destroyed.

Where does that leave small business? That is a real looming question.

Mr. Chairman, let me just divert for a moment, and stretch a point here, and suggest that there may be some parallels between these mindless tactics dealing with the SBA and other events that have occurred recently.

The Acting Administrator, Mr. Heatherly, has been running a covert operation to destroy SBA for almost a year. He has been SBA's Ollie North, if you will, and the munchkins and ideologues have been in charge of micromanaging the whole process. There have been charges of possible illegalities in some of their activities. And in carrying out this operation, the Acting Administrator claims he has been walking in lock step with the President.

I have not seen any evidence that the President has seen or approved a memo for Mr. Heatherly and his new tactic to destroy the SBA, or if the President even met Mr. Heatherly.

If all this was not really serious, it could be quite humorous. But above all, I think the unmitigated arrogance reflected by the administration in these proposals is an insult to the intelligence of this committee and of the small business community as well.

Let me draw this analogy and my testimony to a quick close. I think there is a single important lesson to be learned here and it is a fairly simple one. I would suggest that after Mr. Abdnor is sworn in as the new SBA administrator he should get on with the business of small business—building the companies of tomorrow.

Thank you, Mr. Chairman.

[Mr. McNeish's prepared statement follows:]

PREPARED STATEMENT OF PETER F. MCNEISH, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES [NASBIC]

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March 5, 1987

STATEMENT OF
PETER F. MCNEISH
Before the
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am Peter F. McNeish, President of the National Association of Small Business Investment Companies (NASBIC).

Mr. Chairman, on behalf of the directors, officers and members of NASBIC, let me express our warm congratulations to you on your selection as Chairman of this Committee. I had the privilege of hearing a recent address you made to a small business group in which you outlined a very aggressive agenda for the Small Business Committee. We share your enthusiasm for enhancing the vitality of small business in America, and you can count on our support and cooperation.

NASBIC is the national trade association for the Small Business Investment Company (SBIC) industry. Since our industry is comprised of a specialized group of investment companies that have a very direct relationship to the Small Business Administration (SBA), we have a vested interest in the nature and quality of SBA's budget. Consequently, we greatly appreciate the opportunity to present testimony on the President's FY 1988 budget proposal for SBA, and we commend the Committee for moving quickly to examine the specifics of the Administration's recommendations.

Although we have not seen all the supporting details for the Administration's budget proposal, we have been advised by SBA of the substance of several provisions dealing with the SBIC and Minority Enterprise Small Business Investment (MESBIC) programs.

First, let me note that while there is a limited amount of good news in this budget proposal, the predominant message being sent by the Administration is more bad news.

The good news is that after three years of mindless proposals to terminate the SBA and its financial assistance programs, the Administration has submitted a budget that maintains SBA as an independent agency.

That's the positive element of this budget proposal. But, even here, the Administration should not be showered with praise. The turn-a-round of the Administration's position on SBA came about only because the nation's small business community and the Congress challenged the Administration's efforts to destroy the SBA and its financial assistance programs, and made it clear they would not tolerate another proposal to abolish SBA. It was truly a victory for small business -- based not on politics, but on a recognition of the worth of SBA and the essential financial support its programs provide to the small business community.

But, Mr. Chairman, none of us should be lulled into believing that the idealogues in this Administration have given up their fight. Even a cursory examination of the Administration's latest budget proposal shows that what they could not accomplish through advocating immediate termination of the SBA, and the SBIC and MESBIC programs along with it, they are attempting to do incrementally. Their piecemeal proposals would destroy our ability to operate efficiently and effectively on behalf of small business.

Mr. Chairman, if there is one point the Administration's proposals really bring home it is that enactment of COSBI is absolutely critical to the future of the SBIC program as a stable source of long-term capital for small business.

John Oxendine, speaking on behalf of the National Association of Investment Companies (NAIC), which represents the MESBIC industry, has eloquently described the serious harm that the Administration's budget proposal will cause for MESBICs and the small firms they finance. I won't try to elaborate on those specific items. But, let me make it very clear that NASBIC wholeheartedly concurs with their position regarding the irreparable damage that the Administration's budget proposal will do to the MESBIC segment of our industry. We believe, as do they, that such a proposal, which cuts in half their funding and eliminates the ability of MESBICs to sell preferred stock to SBA, would deliver a death-crushing blow to the MESBIC community.

We trust, Mr. Chairman, that this Committee will quickly and totally demolish this attack on the MESBIC industry.

With regard to the specific proposals concerning the SBIC program, the Administration's recommendations are equally harmful and misguided.

As we understand the budget submission, the Administration is proposing a so-called "freeze" on support for the SBIC program for FY 1988. Using the FY 1987 authorization level as a base, and after netting out both (1) the reduction attributable to the requirements of Gramm-Rudman, and (2) the $14 million add-on for the newly proposed MESBIC guarantees, $233 million is the net amount of actual "leverage" SBA is proposing for regular SBICs during FY 1988.

Is $233 million enough? We think not, even though it's difficult to precisely forecast the industry's liquidity position and need for funds to invest in small firms in 1988. For the record, let me point out that SBICs didn't use all the funds available to them in FY 1986, and it appears they will not draw down the authorized level in FY 1987 either. On the basis of those facts alone one might argue that $233 million is more than ample. But, let's look through the superficiality to some additional details. During FY 1986 and 1987 the lending window for SBICs was completely shut down for over six months, the new funding system took another six months to get up and running on a functional basis, and the cloud of uncertainty over the SBA's future both deterred SBICs from long-term borrowing and inhibited the formation of new SBICs. At the same time, the industry invested funds at record levels for the past two years. Based on these facts, we would argue that the pent-up demand for leverage that has been building for the last two years will surface during FY 1988, assuming certainty in the program and an effective system of funding.

Our conclusion is that (over and above the proposed $14 million for MESBICs) $233 million will fall far short of the necessary funding level for the SBIC program, and a higher mark is amply justified. We would also point out that the SBIC program has now been made an "off-budget" item; so the impact of maintaining, or even increasing, the SBIC funding level has no meaningful budget impact whatsoever. Hopefully, the Corporation for Small Business Investment (COSBI) legislation will be passed during this session of Congress, and the funding ceiling for SBICs and MESBICs will become a moot issue.

Beyond the funding level itself, the Administration has made two additional proposals that would, in effect, make the cost of leverage funds for the industry either inaccessible or prohibitively expensive. I might note, parenthetically, before discussing these two proposals, that the Administration's recommendations come on top of a program change made just last year in P.L. 99-272 that has increased the cost of funds for SBICs by requiring that they go the the public market place for financing rather than to the Federal Financing Bank. That change was adopted -- indeed suggested by the industry -- in order to help this Committee achieve the budget savings necessary to convince the Administration to preserve the SBA's important financial assistance programs.

One of the Administration's proposals would change the current 100% guarantee on SBIC debentures to a 90% gurarantee. The Administration takes the position that reducing the guarantee to 90% would be in line with their policy of "risk-sharing" in federal credit programs, similar to the 90% guarantee in the 7(a) loan program. Superficially, this proposal sounds righteous and proper; who can disagree with the concept that the private sector should shoulder some reasonable exposure to risk. However, what the Administration fails to recognize is that the structure of the SBIC program already puts SBIC investors 100% at risk before the government loses one thin dime. The idea of applying a "risk sharing," 90% guarantee concept to a program where the private sector already stands to lose all of its capital and assets before the government's position is even 1% at risk is illogical on its face. In a nutshell, this proposal makes no sense whatsoever!

It is also clear that the Administration has not considered what the result of such a proposal would be or the impact it would have on the the ability of the SBIC industry to obtain leverage funds! Does this proposal mean that there would only be a "partial government guarantee" in the event of default? If so, how would it work? Could such a security even be sold in the capital markets? If so, at what cost? One investment banker has advised us that he would not be able to sell such a hybrid security! Another has said that such a security might be salable, but because of its unusual characteristics, it could only be sold at extremely high pricing levels. Under either scenario -- one resulting in SBICs being unable to obtain leverage funds at all through the program, and the other making the cost of financing so high as to make it prohibitively expensive -- the result would be the same: the inability of SBICs to obtain leverage; the erosion of capital for small growth firms; and the eventual demise of the SBIC industry.

In summary, this proposal is consistent with the Administration's position in the past to eliminate or cripple the SBIC program.

A second proposal by the Administration would add an additional 1% "users fee" to the cost of SBIC leverage on top of the current 1.185% users fee, which already pays for all of SBA's current costs to operate the SBIC program. As if that weren't bad enough, some of the documentation we've seen discussing SBA's legislative proposals supporting the budget propose even more bad news. One proposal is astonishing in its absurdity; it says that the proceeds SBA receives from the user fee can't be used for it's intended purpose, i.e. to pay for the services used. Instead, SBICs will have to pay for those services a second time. Even more ridiculous, SBA also proposes to add an additional 1% guarantee fee on top of all of this.

Clearly, there is no justification whatsoever for this added taxation of the SBIC industry. It is simply one more way the Administration has devised to raise the costs of the program and heap more expenses on SBICs to make it prohibitively expensive for the industry to obtain leverage. Most important, the SBA seems to lose sight of fact that the poor soul who ultimately pays the freight is the small business. The Administration's objectives seem clear; drive SBICs and prospective SBIC investors out of the program and/or make it impossible for small firms to obtain access to venture capital.

Unlike the 90% guarantee proposal, which would require the enactment of legislation before it could be implemented, we understand that SBA believes it has the power to implement several of these fee proposals through its regulatory powers. We would urge the Committee to take every possible step to prevent SBA from taking any such unilateral action.

Mr Chairman, I might also note that during our meeting with SBA on the budget, we were advised that the Administration would also be submitting a legislative package to the Congress that would recommend a series of additional amendments to the Small Business Act of 1958 affecting the operations of the SBIC program. Based on a cursory review of these proposals, it is clear that the Administration has shifted to a strategy which is designed to incrementally chip away at the SBIC program, piece by piece, until it is eventually destroyed.

The Administration's frontal attack on SBA's credit programs for small business was soundly defeated, but they're still fighting the war. They are attempting to accomplish indirectly what they couldn't do directly. The only thing that's changed are the tactics; the objectives and ideology remain the same.

Hopefully, this Committee will send a strong message to the Administration at these hearings that this less-than-artful dodge is simply unacceptable. In addition, if these proposals are submitted to Congress in the form of legislation, or if SBA attempts to implement any of them through regulatory changes, we respectfully request the opportunity to submit to this Committee a full analysis of their destructive impact on small business, the SBIC program and the future of our industry.

Mr. Chairman, clearly the ability of SBICs to obtain leverage funds -- whether through a government guarantee, or, hopefully in the near future through a government sponsored enterprise in the form of the industry's COSBI proposal -- is the lifeblood of the SBIC industry. If SBICs are unable to obtain these funds because they are prohibitively expensive, this is the same as providing no funds to the program at all -- and the result would be the same as if the Administration's previous recommendation to terminate the SBIC program were adopted. This Committee has stood steadfast against permitting such errant proposals in the past, and we trust that the same course will be followed in the future.

Mr. Chairman, we at NASBIC would again like to applaud the efforts that you and the Committee have taken to ensure the continuation of the SBA and its proven programs. We stand ready to assist you in any way in this effort. We still believe that a steady flow of capital to SBICs, at reasonable rates, provides a time-tested investment in the small business community, the economic growth and competitiveness of this nation, and the production of tax revenues well beyond the cost of the program to date.

We pledge to expand our efforts to design a better alternative structure for the SBIC program and, as always, look forward to working with you and the Committee toward that end. You have assured us of reintroduction of our legislative proposal to create a "capital bank" for the SBIC industry -- the COSBI proposal. Indeed, we are especially pleased that you have indicated that COSBI will be a top priority of the Committee this Congress. We look forward to working with you, your staff and the other members of the Committee on this initiative.

In conclusion, we believe that SBA's budget recommendations before you today provide rock-solid evidence of why enactment of COSBI is so critical to the health and future of the SBIC industry.

Thank you for giving NASBIC the opportunity to submit this testimony to the Committee.

Chairman LaFalce. I think your extemporaneous remarks were much better than your prepared statement. [Laughter.]

Thank you very much, Mr. McNeish. That was extremely helpful and enjoyable.

Again, I will defer my questioning until the end and first call upon Mr. Olin.

Mr. Olin. Thank you, Mr. Chairman. You are really a brave man asking for these brief statements. They get more flowery and much more specific.

I just wanted to ask Mr. Oxendine a couple of questions. I am really not completely familiar with the funding program, the financing program that currently exists. Do I understand that you get a certain amount of direct loans from SBA for your organization?

Mr. Oxendine. No; the way we work, we got about $10 million from the broadcast industry, and we went and opened up a bank account and got a board of directors and a president. And then we went to the SBA and said could we start a small business investment company and they gave us a license.

So every dollar that we took from an investment company, or from our funding corporation and put down in the funding corp, we could get $4.00 for the SBA. Two inexpensive, which would be the preferred stock at 3 percent, two more expensive——

Mr. **Olin**. They buy your preferred stock, is that the way it works?

Mr. **Oxendine**. Yes; that is right. We would say here is the stock certificate; you give us a million bucks and we will give you 3 percent a year.

Mr. **Olin**. They have been buying $19 million worth; is that correct?

Mr. **Oxendine**. Right, approximately, every year.

Mr. **Olin**. And then they would also give you direct loans then to some degree?

Mr. **Oxendine**. Right. Once we put $1 million down, then we qualify for $1 million from them. Then we spend that. And if we have some more deals, then we go back to them and say we would like another $1 million, and they would give us a 10-year debenture. Usually for the first 5 years, we would get a——

Mr. **Olin**. What rate would you have to pay for that?

Mr. **Oxendine**. The Federal funding rate. The rate over the last 5 years has gone from as high as 15 percent down to about 5 or 6.

Mr. **Olin**. And that has been a very satisfactory arrangement.

Mr. **Oxendine**. Not entirely. The preferred stock, the inexpensive.

Mr. **Olin**. You are afraid that if this thing goes the guaranteed loan route that, first of all, the fees and so on are going to discourage the banks. And second of all, the banks will not appreciate small business opportunity as you do.

Mr. **Oxendine**. Exactly. I spent 6 years working as a banker for First Chicago, and I know how bankers think.

Mr. **Olin**. Well, you make a very convincing case, Mr. Oxendine. Thank you very much.

Thank you, Mr. Chairman.

Chairman **LaFalce**. Mr. Mfume.

Mr. **Mfume**. Mr. Oxendine, one of the speakers on the previous panel, I believe it was Mr. Garrett, made a rather serious charge in his concluding remarks. He suggested that things such as the asset sales and the user fees, the lowering of the guaranteed percentage, the transfer of MBDA to SBA, and in this case the almost 50 percent reduction would wreck fundings of MESBIC's; essentially represents an elimination of the agency in a very nondirect manner as opposed to the overt and direct actions that were proposed by the administration in previous budget years.

I assume that you share that position. And if you do, could you state that for the record? And could you also just take a moment to talk about cumulatively what the effect will be in the short term and in the long term; the long term being something just 5 years, but the short term, the next couple of years on the SBA program and what it is supposed to do and designed to do in this Nation?

Mr. **Oxendine**. Well, I think that, for example, the asset sales, if you have $2.24 billion in assets as the SBA does on the books and you are selling it for $277 million, I mean that is a fire sale. That is a message to the financial community that not only do you not want to do what you have been doing, but you want to get out of it, and you are going to have the fire sale.

So I support the things that he is saying. It does seem there is a program by program attack.

When we look at the SBA being dismantled, what it does—the message it sends to the community is that the $170 million that the private sector has invested was a mistake, when it suggests that the preferred stock that we now use is a joke, is a grant as was suggested. In fact, it is not. We paid $30,000 for every million we use. We have paid the Government $60 to $90,000 for the last 5 years, and I am just 1 of 150 that have that responsibility.

So the message to the community when we say we want you to invest because every dollar that you invest will allow us to leverage it four times, they find that to be a joke, because we have a budget that says that those two pieces of inexpensive money are being taken away. And it is also reflected in a number of private sector entities that have gotten into the business.

On average, from 1982 to the present, we used to have about 15 to 20 new entries into the business. Last year we only had eight. So there is a credibility gap. And they cannot believe anything we say because of our actions. On the one hand they talk about promoting minority entrepreneurship. On the other hand they take it away from what we are doing. So I think that I am in accord with the gentleman's statements before.

And I think in the short term, it just backs us up. We are backed up 6 months now. If this proposal went through, we would be backed up a year. And the small businesses and the small companies like ourselves would just go out of business.

Mr. **Mfume**. Thank you, Mr. Chairman.

Chairman **LaFalce**. Thank you, Mr. Mfume. I think you have both made excellent statements, and we would have asked you many questions had not the bells rung. But since they have rung and since we have about 9 minutes to cast our vote on ordering the previous question to the rule accompanying H.R. 558, the Small Business Committee will adjourn. Thank you very much.

Mr. **Oxendine**. Thank you.

[Whereupon, at 12:10 p.m., the committee adjourned, subject to the call of the Chair.]

APPENDIX

Letter From Hon. Mervyn M. Dymally, a Representative in Congress From the State of California, and Chairman, Congressional Black Caucus

Congressional Black Caucus
Congress of the United States
H2-344 House Annex #2
Washington, D.C. 20515

202 — 226-7790

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John Lewis	GA	'87
Kweisi Mfume	MD	'87

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Steering Committee

March 5, 1987

The Honorable John L. LaFalce
Chairman
Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your interest in receiving the views of the Congressional Black Caucus (CBC) with respect to the Administration's FY 1988 budget for the Small Business Administration (SBA).

Upon receipt of your correspondence, the hearing dates were so rapidly approaching that there was not time to revise my schedule to permit direct involvement. However, many members of the CBC are very concerned about the budget request for the SBA and we ask that this correspondence be included in the record on behalf of the Caucus.

As noted in your request for testimony, the reduction of assistance to minorities encompasses five specific areas: 1) 7(j) call contracts would be cut in half and restricted to trade groups, 2) business development expense grants would be eliminated, 3) MESBIC preferred stock purchases would be eliminated, 4) Direct economic opportunity loans would be eliminated, and 5) the Minority Business Development Agency would be transferred to SBA.

The CBC is adamantly opposed to these proposals and alarmed at this attempt at incremental destruction of programs designed to assist minority businesses. Equally frustrating is the proposal to transfer the Minority Business Development Agency to the Small Business Administration under the guise of strengthening the Minority Business program when all other aspects of the Administration's proposal show an obvious attempt to make SBA expendable in the budget debate.

Mr. Chairman, in your correspondence you requested that the CBC speak to the first four of the five areas that would effect minorities. You suggest that it is not yet time to address the MBDA transfer proposal as the Committee does not have any details on the proposed transfer. It is our contention that this is precisely the reason to have hearings on the matter, as a source of obtaining the details.

The CBC respectfully requests the scheduling of hearings to specifically address the five areas of the Administration's proposal that call for the reduction of assistance to minorities in order to explore the potential effect on minority business.

Again, thank you for soliciting our views on these issues and we look forward to working with you in the future.

Sincerely,

MERVYN M. DYMALLY
Chairman

PREPARED STATEMENT OF HON. G.V. (SONNY) MONTGOMERY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI, AND CHAIRMAN, COMMITTEE ON VETERANS' AFFAIRS

Mr. Chairman, I appreciate the opportunity to present my views on the President's proposed Fiscal Year 1988 budget for the U.S. Small Business Administration. My concern especially relates to the administration's proposal to discontinue direct small business loans to Vietnam era and service disabled veterans.

The original GI bill of World War II and Korea authorized a small business loan program under which the Veterans Administration guaranteed small business loans for returning veterans. However, there was no similar provision in the GI bill for Vietnam era veterans.

Congress, however, in recognition of the sacrifices made by Vietnam era veterans, included a provision in Public Law 93-237 which mandates special consideration for veterans in obtaining direct and guaranteed small business loans administered by the Small Business Administration (SBA).

Over the years the Veterans Affairs Committee received many complaints that the special consideration provisions of Public Law 93-237 were being ignored by SBA, or that progress in implementing them was insufficient. These views were confirmed at a series of hearings at which national representatives of veterans service orgaizations expressed their frustration and disappointment over the lack of progress in responding to the needs of veterans in obtaining small business loan assistance.

Congress subsequently enacted Public Law 97-72, which authorized a small business loan program in the VA for disabled and Vietnam era veterans. The Administrator of Veterans Affairs was authorized to make or guarantee business loans up to $200,000 to businesses owned by Vietnam era veterans, or veterans rated 30% or more service disabled. Funds for operating this program were appropriated to SBA rather than to the VA, in view of SBA's more current expertise in business loan matters.

While Vietnam era veterans were serving their country in a bitter and divisive conflict, their civilian counterparts were entering the mainstream of American business. When they now want to become entrepreneurs, their own position is, necessarily, one of "catching up." The same is true of disabled veterans, who may face extraordinary challenges in starting or expanding their own businesses. It is on this basis that I, and the Veterans Affairs Committee, have strongly supported these small business loan initiatives and associated support activities.

SBA's direct loan program for Vietnam era and service disabled veterans assists about 250 to 300 veterans per year, with an average loan size of approximately $64,000. This is a modest program which is targeted to helping people who, through service to our country, have earned our gratitude and our support. The fact that funding for Fiscal Year 1986, and through the first quarter of Fiscal Year 1987, has been fully utilized is certainly an indication of ongoing demand for the program.

Our nation has belatedly offered Vietnam era veterans the type of recognition so readily and rightly bestowed on veterans of previous wars. It behooves us to put substance behind the rhetoric, and to provide meaningful programs to assist these veterans in their readjustment to civilian life.

I strongly support the direct small business loan program for Vietnam era and service disabled veterans, and urge that the administration's proposal to discontinue it be rejected.

ANSWERS TO WRITTEN QUESTIONS SUBMITTED TO CHARLES HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, FROM HON. JOHN J. LAFALCE, CHAIRMAN, SMALL BUSINESS COMMITTEE

Question 1:

Historically, the SBA, as is true with all agencies, submits to OMB their views on the budget necessary to support three levels of funding: (1) improved; (2) reduced; and (3) maintained. Did you do so for 1988? Please submit a copy of your recommendations for the record.

Answer:

Because of the change in the Administration's position on continuation of a viable and independent SBA we had no "planning ceiling" on which to base our request and, thus, the formulation of the FY 1988 Budget Submission for SBA was handled quite differently than in the prior years.

This budget request was formulated as a joint cooperative effort on the part of SBA and OMB. All factors and issues, and not just simple options based on purely monetary savings, were considered. Representatives from OMB worked very closely with the Acting Administrator, his staff and the program officials to determine the appropriate levels of funding to request from the Congress. Thus, it was not necessary for SBA to develop and submit to OMB such optional levels of program funding.

We feel that the end result is a request that balances the Administration's deficit reduction objectives with the Agency's mission requirements. The FY 1988 Congressional Budget Submission, as submitted to you, outlines these specific programmatic requests that resulted from the negotiations between SBA and OMB representatives.

Question 2:

Among the reasons advanced by certain people in the agency for eliminating some of the financial assistance currently being offered is: "Access to the capital markets by small business, including MESBICs, has improved to the point where both investment and loan capital is readily available at reasonable cost from within the private sector to meet most of the small business financing needs." Do you agree with this statement?

Answer:

Under present economic conditions - yes. Economic data, such as growth in total investments from $2.5 billion in 1977 to $16.3 billion in 1984, supports such viewpoint. Furthermore, our own data seems to indicate that this is the case. For example, 37% of the financing provided to small businesses by MESBICs during calendar year 1986 went to firms in the local and urban transit industry, largely to finance taxicab medallions and taxi and limousine vehicles in New York City. SBA is aware that banks and credit unions in New York City also finance this industry on competitive terms. Furthermore, we have information that several of the licensees engaged in this activity have paid substantial dividends to their stockholders and have raised significant additional capital through sale of their stock to private investors.

The Administration's proposal will bring MESBICs closer to the mainstream of the financial marketplace and in a gradual way reduce their dependence on low-priced Federal funds, or in the case of preferred stock, virtually no-cost Federal funds.

Question 3:

As I noted at the outset, I am very distressed that it has been nine months since the agency had a permanent administrator. It is inconceivable to me that the proposals being presented to the Congress have not been subject to the scrutiny of a permanent administrator but may simply be the whims of a bureaucrat in the bowels of the Office of Management and Budget. Can you tell us the status of any nomination?

Answer:

On March 20, the Senate confirmed the Honorable James Abdnor as Administrator of the Small Business Administration. President Reagan had announced an intent to nominate Senator Abdnor several months ago, in December 1986.

Question 4:

I am curious about personnel changes during recent months. I would appreciate your supplying for the record complete information about any positions you have filled in the last ninety days at levels of GS-11 or above, with particular reference to any which have been filled by converting non-career people into career.

Answer:

Clarification regarding this question was sought and obtained from Tom Powers, Committee's General Counsel, by Stu Remer, SBA Deputy Director of Personnel. The above question was narrowed to request for a list of those GS-11 or above individuals who, within the last 90 days, converted from non-career conditional (competitive status) appointments. The following represents the only two cases falling into such category:

1. Logan Salladay, Conversion to Reinstatement - Career

FROM: Consultant $268.24 per day
Office of Business Development
Washington, D.C.

TO: Business Development Specialist, GM-1101-13, $50,346 pa
Office of Business Development
Washington, D.C.
Effective: 3/15/87

2. Alice E. Wyatt, Conversion to Career Conditional Appointment

FROM: Loan Specialist, GS-1165-11/1 (Disaster Temporary)
Charlotte, North Carolina District Office

TO: Loan Specialist, GS-1165-11/2
Charlotte,, North Carolina District Office
Effective: 2/15/87

Question 5:

In your statement on page 16 you cite the number 4,227 as the FTE or full-time equivalent for employment being requested in 1988. Isn't it true that this includes 140 proposed for transfer from MBDA and that otherwise you are asking for a reduction of 29 bodies from the 1987 level?

Answer:

Yes, the 4,227 full-time equivalent level for FY 1988 includes 140 FTE's for MBDA functions. The reduction of 29 FTE's for SBA from FY 1987 reflects reductions in employment levels expected as a result of Agency efficiency improvement and cost optimizing activities prior to and in FY 1988.

Question 6:

Under current procedures, SBA does a cursory background check of applicants for assistance in some categories as to whether or not they have a criminal record. I understand that the current practice is to check their names, but that discussions are underway with the FBI to instead submit fingerprints and have them checked. What can you tell us about this?

Answer:

Currently, the SBA, as part of the process for determining eligibility, conducts a name check through the indices of the Federal Bureau of Investigation (FBI) on all applicants for SBA assistance.

These checks are conducted by name and other identifying data and have proven to be very beneficial. This process is the only check of an applicant's "good character," which is a requirement for an SBA loan.

The criminal history checks do result in a significant risk reduction for the agency. Between the period from April 1, 1986 to September 30, 1986, a total of 35,401 name checks were conducted and, of that number, 3,023 uncovered unfavorable information. After additional inquiries were made the agency declined 63 loans totaling $5,241,482 for reasons relating to the applicant's character, current parole/probation status, or because of a history of criminal offenses.

The Agency has now been notified by the FBI that, as of April 1, 1987, searches of the FBI Identification Division Criminal File for noncriminal justice use will be done only through the submission of fingerprint cards. The FBI has subsequently agreed to a 30-day postponement to May 1 for implementing the new procedures. The implementation of this requirement would ensure that a person on whom a criminal history check is being requested does not avoid being detected by merely changing his/her name or other identifiers. Also, fingerprints ensure that the record found belongs to the person being checked. Additionally, fingerprints ensure that an applicant for licensing or other assistance is not wrongfully denied such assistance because he/she is incorrectly identified with a criminal record.

The SBA requests more name checks annually than any other Government agency. We have been in contact with personnel in the Commerce Department, which is the second largest requestor of name checks. They informed us that they require applicants for Commerce assistance to submit a fingerprint card completed by a recognized law enforcement agency.

We are sensitive to the possible negative reaction on the part of applicants, participants, and volunteers to this requirement. As a result, we have been working to achieve a proper balance between our desire to provide efficient program assistance with a minimum of inconvenience to our borrowers, and the necessity of complying with congressional intent that individuals involved in our programs must meet certain character requirements.

One problem common to any program requiring fingerprints is the resubmission of unclassifiable prints. In many instances, including background checks for government employment, this requires the applicant be reprinted until a readable set is obtained. We feel such a procedure would cause undue inconvenience and have reached an agreement with the FBI that enables us to only require one submission of two fingerprint cards with each application. This procedure will minimize any inconvenience by ensuring that applicants will only have to be printed one time.

Another sensitive issue involves the printing of disaster victims and volunteers in the various management assistance programs (SCORE, ACE). We recognize the image problems which would be created by requiring victims to subject themselves to fingerprinting upon making their initial applications at disaster centers. We are studying the feasibility of modifying the process so data necessary to complete the background check can be forwarded later in the process, at a much more convenient and less emotional time for the victim. We are also considering a modification of the background check in the area of program volunteers, which may eliminate the necessity for these individuals to submit fingerprints.

We are working closely with program officials and the FBI to ensure a smooth transition to the system. We will keep you apprised of any significant developments or changes in the program.

LEGISLATION

Question 1:

In your testimony, you state that you will be submitting legislation to carry out those parts of the budget for which you deem legislation to be needed or helpful. When do you expect this to occur? Where is this legislation now?

Answer

Draft legislation on all budgetary proposals requiring separate legislative action has been developed and is currently being reviewed by the Office of Management and Budget (OMB). We will share copies of the draft legislation with your committee as soon as we have OMB clearance.

Question 2:

Is there additional legislation, other than budgetary, that you will be submitting? If yes, what and when?

Answer

All of the legislation drafted to date is tied to our FY 1988 budget proposals. At present, we have no plans for additional legislation.

Question 3:

In attachment IX, number 7, you indicate that no legislation is needed, only appropriations, to increase surety bond guarantees to $1,250 million in 1988. Since the currently authorized program level is $1,142 million for 1988, are you simply proposing an appropriations' over ride of the authorizing legislation to increase it to the higher level?

Answer:

We, of course, would prefer the appropriations to conform with the authorizing legislation. However, in the event that Congress did appropriate a level of $1,250 million for Surety Bond guarantees by specifying such program level within the appropriation statute enacted into law, we then would view such appropriation statute as a later legislative statement that supersedes previously authorized levels. We would hope that conforming authorizing legislation is enacted simultaneously to prevent any legislative confusion.

LOAN CONSOLIDATION AND ELIMINATION OF DIRECT LOANS

Question 1:

When then OMB Director Stockman testified before the Senate Small Business Committee two years ago, he made considerable ado about loans simply going to small business in general. Now you want to eliminate specific programs which are directed to handicapped, economically disadvantaged, and to disabled and Vietnam era veterans and basically leave the agency with one big pot from which to disburse assistance to one and all. This proposal seems to me to be a repudiation of the concept of targeting loans. Do you agree? Are you opposed to targeting loans to certain areas of the small business sector?

Answer:

This Administration has been and remains opposed to so-called targeting. We believe that the free market is a better mechanism for allocating resources than is the government.

The basis for the consolidation proposal is that under existing law SBA has authority to make loans to the following categories of borrowers:

1. To any qualified small business concern.
2. To any small business concern owned by a low-income individual or located in an area with high proportions of low income or unemployed individuals.
3. To any small business concern in the energy business.

Categories two and three are subsets of category one. Any loan that SBA can make to a category two or category three borrower, it can make under the category one authority. It has been the agency's experience that loan applicants hear that SBA has special loan programs for energy and for economic opportunity and presume that they are really different and "special". Then we must explain to them that these programs have identical, or very similar, applications requirements, interest rates, terms, conditions and even the credit criteria. Government's credibility can be seriously impaired by continuing to present to the public a set of distinctly-named programs that are in fact identical.

Existing law also provides a separate authority for loans to public or private organizations for the handicapped or to assist any handicapped individual in establishing, acquiring, or operating a small business concern.

SBA's proposal would integrate these three separate authorities into the general business loan authority. All classes of borrowers that are eligible under current law would continue to be eligible under the bill.

It is not sound policy for the law to require SBA to maintain separate programs that are separate in name only. Their combination would be prudent and easily accomplished. However, even though the financing would be provided under the broad category of "General Business", SBA will maintain the necessary emphasis on the needs of these special classes of borrowers and its ability to continue to report on lending activity by each category of borrower.

Question 2:

Your statement on page 19 also concludes that the elimination of direct loans to handicapped, economically disadvantaged, and to disabled and Vietnam era veterans will not have any substantial effect on these groups because most of SBA's assistance today is in the form of guaranteed loans.

I would simply point out that since direct loans are available only to those who cannot obtain bank financing even with an SBA guarantee, elimination of the direct loan program means that those small businesses will not be helped.

It also seems to me that you are suggesting that we approve substantial increases in the level of funding for these programs as then any proposal to eliminate the program would have an adverse impact on a substantial number and thus would not be acceptable.

Answer:

No, we are not indirectly advocating expansion of these programs. We are only suggesting that, because of substantial changes in the investor or lender attitudes and improved general money market conditions, adequate credit at reasonable terms is now generally equally available to all small business entrepreneurs.

It has to be noted that ability to repay is a prerequisite condition for obtaining either SBA direct or guaranteed loans. That means that a prospective borrower has to meet identical minimum financial criteria to qualify for either type of loan. In the past direct loans were principally needed to overcome the erroneous perception on the point of some lenders that the entrepreneurs falling into such groups were poor risks. We believe that this has changed and that the banks now generally evaluate each loan request on individual merit, thus, diminishing, if not totally eliminating, the need for alternate government source of funds to meet the needs of these special category businessmen.

GUARANTEED LOAN PROGRAM CHANGES

Question 1:

You are proposing to double the amount of the fee on guaranteed loans from 2% to 4% and I would note that this would amount to a quadrupling in less than two years. What impact do you expect this to have on loan demand and the ability of a borrower to meet loan standards? What is the basis of your answer---have you surveyed bankers or what? Exactly what is the 4% designed to recover, that is, cost of the program or what? At what fee would the program become entirely self-supporting? At what point would fees be so high as to effectively eliminate the program?

Answer:

The answers to these questions are complicated. These issues have recently been analyzed in a report prepared by SBA at the request of the Committee. Relevant sections from the report, Alternative Sources for Loan Guarantees, A Report to Congress by the U.S. Small Business Administration, June, 1986, are attached.

Said report, however, does not address the issue of at what point would fees be so high as to effectively eliminate the program.

Obviously, if fees are raised continuously, they would reach a point at which lenders and borrowers could no longer afford to participate. SBA has not conducted a study of this question, because we believe that the fees proposed in our budget are well within the range of affordability.

Under the budget proposal the fee level would be established at 4%. In implementing the legislation SBA would permit 3% to be charged to the borrower. One percent would be paid by the lender and could not be passed through to the borrower.

To analyze the impact upon borrowers, consider a typical SBA guaranteed loan of $150,000 with a term of 9 years and a 10.25% interest rate. The monthly payment is $2,132. Assuming that the guaranty fee is increased by 2% and that half the increase is financed by being capitalized into the value of the loan, the loan amount would increase to $151,500. The monthly payment would rise to $2,153, an increase of $21, or only 1%.

The lender would pay one point, or $1,500. Given the profitability of SBA lending, a one point fee should not have a serious impact upon lenders.

Question 2:

You are also proposing to reduce the percentage of guarantee to 75% by 1992. Obviously this will result in lower loss rates as you claim, but the same rationale says that even lower loss rates would result if SBA only guaranteed 50% of the loan and even lower losses would result at a 10 or 20% rate.

The question is where to draw the line because at some point you are not helping small business to acquire financing. Do you really believe that the government, should be providing financial assistance to small business or should all of the loan programs be privatized?

Answer:

We believe that the government should be providing financial assistance to small business through the SBA Finance and Investment programs to the extent needed to ensure that the Nation's small business sector has equal access to sources of capital and is able to meet its capital needs at fair and reasonable cost.

Therefore, many factors, not just the lowering of the loss rates, have to be taken into consideration in determining what the percentage guarantee should be to obtain the optimum social and economic benefits. We believe that, in light of the current conditions and trends within the money/financial markets; given stable economy, monetary and tax policy; balancing this against the need to face the realities of the country's fiscal situation, the need to improve competitiveness of our industry and markets, etc.; the 75% guarantee level will produce results much closer to the optimum than the current 90%.

Question 3:

On page 21 you state that the proposed 75% guarantee level is significant enough to assure continued lending by private financial institutions to small business. What is the basis for this conclusion? What input have you received from the banking industry? Do you believe that there will be a different impact on guaranteed loans by banks as contrasted with those from non-bank lenders?

Answer:

In the 1983 GAO Report on the 7(a) guaranty program, lenders were asked what would happen if the guaranty percentage were reduced to 80% and to 70%. (GAO/RCED-83-96). Their percentage responses were as follows:

NUMBER OF SBA LOANS APPROVED

	Somewhat Increase	Remain About The Same	Somewhat Decrease	Greatly Decrease
80% Guaranty	4	58	29	7
70% Guaranty	1	23	48	28

Furthermore, in informal conversations, members of private lenders have indicated that 75% guaranty level would not induce them to cut back lending to small business. Of course, we do expect the impact of a drop in the guaranty level to be somewhat greater on Small Business Lending Companies (SBLC's), CALBIDCO's and other non-depository institutions than on banks and Savings and Loans. SBLC's and to an extent, CALBDICO's, do only SBA lending, while banks are engaged in many other activities and SBA lending is usually only a small percentage of their total loans and investments. In addition, the cost of money is probably higher for SBLC's and CALBIDCO's than it is for banks.

Question 4:

Under your preferred lenders program the bank has to accept a lower guarantee rate than might be made available under the regular program, even to a certified lender to whom you will provide an answer in three days. I understand that the PLP program is operating very substantially below original projections, and I have heard that the reason is basically due to lenders' reluctance to take the lower guarantee. Please comment.

Answer:

PLP has fully met SBA expectations. PLP lenders continue to process some loans through CLP and also some through regular processing. A lender never loses its previous status. Not all loans qualify for PLP. The more active a PLP lender is, the more all his loans are apt to be PLP. Recent lowering of tha overall 7(a) guaranty percentage on some loans to 85% has narrowed the gap between PLP loans and others, thus, reducing reluctance to take the 75% guarantee.

SALE OF ASSETS

Question:

Although we will be holding specific hearings on asset sales in two weeks, I would nonetheless appreciate a short summary of the status of this proposal and your timetable.

Answer:

We are currently in the implementation planning phase of the asset sale program. Our first major task had been to set in motion the steps necessary to obtain services of an independent financial advisor to assist the SBA in developing a marketing plan for the sale of the loans to investment markets. On March 30 of this year, the firm of Paine Webber was selected to provide us with such services. This selection was based on a comprehensive review of all proposals that were submitted in response to a RFP (Request for Proposals) that was issued on January 23, 1987.

The Advisor's first task will be to assist SBA in the development of a comprehensive management plan for the asset sales. The plan will analyze the marketing strategies and the effects on cost and net revenue of a sale of assets both without and with partial, or full recourse to SBA. After review and any necessary modifications, SBA will consider adoption of the plan to serve as the overall strategy for the sales.

Next, the Advisor will assist SBA in structuring the loans in the portfolio into marketable units that can be readily sold to private investors. Loans could be packaged in various ways. They could, for example, be grouped or pooled in relatively homogeneous units with common characteristics such as interest rates and maturity, or they may be grouped without regard to such characteristics. A pool might be established in which undivided interests in such a pool might be marketed, or used as collateral for a separate securities offering.

Finally the Advisor will develop marketing strategies to carry out the sales of the structured loan packages. Among other possibilities, marketing options might include:

-- Selling the loan packages to a single financial institution that will act as an intermediary for collection and servicing the loans on behalf of the investors;

-- Selling several packages to one or more financial intermediaries for resale to investors;

-- Sale on a local or regional basis to intermediary financial institutions which purchase for their own account; or

-- Direct sale to investors.

The investment advisor will analyze the advantages and disadvantages, anticipated proceeds, expected prices and discounts, and make recommendations on the timing of the sales. SBA will then consider the recommendations contained in the final report and initiate appropriate actions.

DISASTER LOANS

Question 1:

Effective in 1989 you propose denying disaster loan assistance to those who can obtain credit elsewhere. It seems to me that if you find than an applicant does not need a loan you can just set the term so low that it is unattractive. In fact, the statute sets the maximum term of such loans at not more than three years. Why have you not used the shortened term as an answer for this situation?

Answer:

The statute sets the term at 3 years for business loans with credit available elsewhere, but not for home loans. Generally, we insist on a shorter term for loans when credit is available elsewhere. The term for home loans is based on repayment ability, thus, the terms are always longer for the less affluent applicants who cannot obtain credit elsewhere.

However, use of a shortened term as a tool to impose what could be interpreted as a "social policy" has limitations. For one, that imposes undue pressures and responsibilities on SBA field personnel to make additional, often highly subjective, judgments as to the applicant's ability to repay at a specific rate. The pressures can be overbearing as the SBA disaster loans, especially home loans, are, because of their interest rate, in high demand. Under current law, the maximum interest rate for homeowners with credit elsewhere is 8 percent, which is below market in most of the country even in these days of low interest rates.

A clearcut policy of denying disaster loan assistance to those who can obtain credit elsewhere would simplify loan processing, would speed up the process of providing resources to the most needy, and would ensure that the taxpayers funds are not used to provide unjustifiable subsidies.

Question 2:

You also want to raise the interest rate on disaster loans to those who cannot obtain credit elsewhere to cost of money plus one percent. Have you calculated how many disaster victims will lack the ability to repay the loan at double the current rate and thus will be denied any assistance?

Answer:

We have not made this calculation. However, we believe that the subsidy levels on these loans can be substantially reduced before having effect on disaster victims ability to obtain needy assistance.

This measure is proposed with the intent to reduce the subsidy level on the disaster loans to a more reasonable level. At the current rates, the direct subsidy on loans to a borrower, without credit available elsewhere, is equal to the difference between the average cost of money to the Government less 4 percent, for every dollar outstanding, as long as it is outstanding. Total subsidy level is even greater, as other costs, such as the cost of administering the program, servicing the loan and the losses incurred due to defaults, must also be considered.

Question 3:

On page 24 of your statement you say that your proposal will encourage disaster victims to use established private sector sources, like insurance.

First, I do not believe that any rational being sits back and decides not to buy insurance because he or she knows that SBA will or may make loan assistance available.

And second, in many instances insurance is not available, for example, flood insurance, unless the local government does re-zoning and takes other affirmative action.

What about individuals who cannot obtain insurance?

Answer:

The comment on the behavior of rational beings may be accurate. However, the availability of disaster loans at below market interest rates does not encourage a potential disaster victim to purchase adequate insurance.

With respect to flood insurance, the Federal Government makes it available in all special flood hazard areas. Of the 22,000 flood-prone communities (1% chance of flooding in any given year), 17,700 participated in the National Flood Insurance Program (NFIP) in 1985. Of the 4,300 non-participating communities, 99% did not participate because either the flood hazard area was small, or covered an undeveloped area which the community agreed to leave undeveloped. To be part of the program, the local government is required to adopt and enforce certain flood damage mitigation regulations. If a community refuses to adopt these measures or to enforce them, the community can be suspended from the program. In such communities ("under sanction"), SBA is prohibited by law from making disaster assistance available. Thus, applicants who now cannot obtain flood insurance because their community has refused to adopt or enforce required flood damage mitigation measures are not eligible for disaster loans in those communities.

Finally, it should be noted that our policy of encouraging use of available insurance is in accordance with the 1980 GAO Report (PAO-80-39) which states that "insurance is superior to alternative means of delivering disaster assistance..."

SMALL BUSINESS INVESTMENT COMPANIES

Question:

You are proposing to reduce the amount of an SBA guarantee on SBIC debentures to 90% from the current level of 100%.

I would be interested in the basis for this proposal. What makes you think it would work? At what price would you expect the debentures to be purchased by investors?

Answer:

This Administration in OMB Circular A-70 clearly sets forth its policies and guidelines for Federal credit programs. SBA's proposal implements that policy and those guidelines. One of the stated purposes of that circular is to encourage individuals and private financial institutions to view the private sector as the primary source of credit.

The OMB's principles of Federal credit policy and the standards for their implementation require a significant sharing by private lenders of risk of loss from a default. Sharing of 20% of the risk of default is considered significant. SBA's proposal for a 10% risk sharing is below that OMB guideline because of the higher risk nature of the SBIC program.

SBA has wide experience with the origination of 90% SBA-guaranteed loans and the pooling and selling of the guaranteed portions of those loans, or certificates representing ownership of those loans, to private capital markets. This program is successful with the new volume in 1986 reaching $938.9 million.

It is important to clarify at this point that the security sold under the above referenced existing program is 100% guaranteed by the full faith and credit of the United States in spite of the fact that the underlying small business loans are only 90% guaranteed. Only the guaranteed portions are pooled and thus the securities backed by the pools are 100% guaranteed. The proposed new SBIC financing program could be much the same, that is, it could use third party risk sharing for the unguaranteed 10% portion.

Until the actual marketing of such a new program, it is not possible to tell what, if any, added cost would be involved on this new program. The changes mandated by the Congress under the COBRA legislation of 1986 suffered from the same uncertainty as to added costs. Theoretically, the 90% guaranteed portion sold to the public markets through the pooling method would be priced using the same comparable securities now being used, and thus, everything else held constant, the cost would be the same 80 to 125 basis points over the 10-year Treasury rate. There would likely be added costs on only 10% of the borrowing and we estimate that the impact on total costs of the increase in the costs of the 10% unguaranteed portion would not be prohibitive. The actual debenture would bear a rate and would be sold at a price which would blend these proportionate risk differences.

POLLUTION CONTROL BONDS

Question:

Your proposal is to eliminate this program which assists small business in obtaining financing for their pollution control facilities which are mandated by the government, with this financing being over a long term which generally is not available through loan programs. Part of your argument is that the program was originally designed to be used in connection with tax exempt bonds which are no longer available and that thus the program has fallen into disuse and can be eliminated.

I understand that several years on the drawing boards, the private sector has not developed a plan to participate in the program on a taxable basis. And I believe that the agency began approving such applications last year.

Just because demand is low, as you say on pages 23 and 24, is no reason to eliminate a program.

I would appreciate an update and your position on taxable applications which you are now approving.

Answer:

Taxable financings have always been eligible for Pollution Control Financing Guarantees, and several have been completed dating back even to the early days of this program. Tax-exempt bonds became the financial vehicle of choice because they offered much lower interest rates than taxables during the years when interest rates in general accelerated to record levels. These same years in the late 1970's and early 1980's saw wide spreads between taxable and tax-exempt rates and inverse relationships of long to short term rates which no longer exist. They were also the years of greatest usage of this program. This apparent parallel between the rise and fall of interest rates and the rise and fall of activity in this program is probably not coincidental.

The following table shows Pollution Control Financing Guarantees approved for both taxable and non taxable financings during Fiscal Years 1983 through 1987 to date.

Fiscal Year	Number of Approvals	Total Principal	Taxable	Non-Taxable
1983	4	$ 8,205,000	$ -	4($ 8,205,000)
1984	3	$11,025,000	$ -	3($11,025,000)
1985	5	$ 7,775,600	2($ 700,000)	3($ 7,075,600)
1986	14	$26,375,780	10($9,235,000)	4($17,140,780)
1987*	2	$ 5,700,000	2($5,700,000)	-

* As of 3/18/87

We respectfully submit the foregoing information does not indicate need that would justify the continuation of this program.

SMALL BUSINESS DEVELOPMENT CENTERS

Question:

Among your proposals in this area is one to reduce 1987 funding by $4.1 million to $31 million by a rather unique method. You use the term "re-appropriation." In essence, you have already subtracted this sum from the appropriated amount but are not treating it as a deferral or rescission under the Budget Act. Have you ever asked for a re-appropriation of any other item? If not, where did you get this idea?

As I understand it, you have withheld spending this amount until Congress acts on your re-appropriation request. When will you release this money if Congress does not act (and I would certainly hope that your answer would not pick a time so late in the fiscal year that the funds lapse due to lack of demand)?

I understand that there are other states that are interested in forming an SBDC, but that they have been discouraged from developing an application because your program office has told them that no funds are available. Are you aware of this? If not, please respond for the record.

Answer:

This budget proposes that $4.1 million of the 1987 allocation be used in 1988. This was principally initiated because we believed that no additional SBDC's will be truly ready to start operations during FY 1987 and, therefore, the delay in funding additional SBDC's until Congressional direction regarding the future scope of this program is obtained would not cause any major impact on availability of services to the small business sector. We simply do not believe that these funds can be put to efficient use by prospective new SBDCs this year.

If Congress decides to reinstate the $4.1 million into the 1987 budget, then of course, we will make the funding available at once. This will require accelerating approval and start-up of one or two SBDC's who are now in the planning stage. Then the proposals that have met all the requirements and are ready for final approval would be approved and funded.

Presently, there are 42 states plus the District of Columbia, Puerto Rico and the Virgin Islands participating in the SBDC Program. States not participating include California, Colorado, Arizona, Montana, New Mexico, Hawaii, Maryland and Virginia. Over the past several months all of these states have expressed interest in the Program to varying degrees, but have not submitted a formal proposal (application). In discussing the Program with these states, we informed them of the Administration's FY 1988 Congressional Budget Proposal regarding SBDC's. We also informed them that experience shows that applicants generally take from six months to a year developing a proposal package that fully meets the legislative requirements of the Program and the policy and procedural requirements of the Agency. This we do not consider as discouragement, but an honest statement of fact.

MINORITY ASSISTANCE

Question:

In this area you are proposing the elimination of $19 million in purchases of preferred stock from MESBICs. In lieu, you want to provide $14 million in regular SBIC debentures.

a. Please explain how the new money will be made available;

b. Please explain how that debentures with an interest rate set by private investors who will be purchasing these debentures is in any way a substitute for preferred stock purchases on which the cost of money is a 3% dividend payable only if there are earnings. I see a world of difference between debt service which involves mandatory market rate interest and optional dividends;

c. This proposal has a familiar ring to it---the purported substitution of higher cost money for lower cost SBA money with a claim that the total assistance is not being changed, merely the mix. In 1980, SBA was providing economic opportunity loans to assist minorities. In that year most of the money, as in previous years, was in the form of lower interest direct loans as compared to higher interest rate bank guaranteed loans. Specifically, there were $63 million in direct loans and $25 million in guarantees. Then came the administration's proposal to reduce direct loans. But this would not reduce loans to minorities because more money would be made available in guarantees. Can you guess what I am going to tell you happened? The bottom fell out of minority loans so that last year the total EOL program was $46 million, of which $14 million was in direct loans and $32 million was in guarantees. This mind you was even after a strong push and goal setting etc. Do you have any reason why history will not repeat itself if the current substitute is approved.

d. On your proposal to transfer MBDA, the Minority Business Development Agency from Commerce to SBA, I find that we have almost no information. This hearing is not on that particular proposal so I just would request that you submit for the record more particulars such as the details of discussions with Commerce and your own evaluation and enumeration of the problems involved in such a transfer, your solutions and the timetable.

Answer

a. First, the proposal is for a total authority of $34 million of which $14 million would be allocated for 90% SBA-guaranteed debentures, and $20 million allocated for the direct purchase of subsidized debentures. The Administration's proposal would eliminate funding by SBA direct purchase of preferred stock with no intent to replace it with any other type of subsidized funding. The proposal is to step the MESBIC program away from the subsidies and bring it into the mainstream of the non-subsidized financial marketplace.

The SBA-guaranteed MESBIC debentures would be 90% guaranteed by SBA and would carry terms and conditions, including interest rates identical to those of regular SBIC guaranteed debentures. They would be funded in the same pooling system now used for SBICs and would be integrated into the periodic pools now formed by SBICs.

b. The 90% SBA-guaranteed debentures are not intended to be a substitute for the MESBIC preferred stock financing but rather a step into the non-subsidized financial marketplace.

This Administration has no evidence that the existence of subsidized Federal dollars over the past 15 years insures the prosperity or survival of MESBICs. For example, 62 MESBICs representing 23% of all MESBICs ever licensed have been transferred to SBA's Office of Portfolio Management for liquidation. These 62 MESBICs had $76.1 million of Federal loans and preferred stock representing 21% of the total of all funds ever disbursed to MESBICs by SBA.

It is the Administration's opinion that the long-term interests of the MESBIC program would be best served by an orderly transition of the program into the private financial sector. MESBICs themselves have the same opinion as they are embracing the COSBI concept of complete privatization.

c. Overall SBA lending in both FY 1985 and FY 1986 was below the levels of FY 1980. A major reason was the higher credit standard set under SBA's quality lending policy and improved availability of funds from commercial lenders.

SBA lending in 1986 was also below the level set in the Gramm-Rudman-Hollings-adjusted Appropriation Act. One likely explanation is that current low interest rates together with ready availability of funds within the financial markets had reduced the demand for SBA assistance. Uncertainty over the future of SBA was also probably an important cause. Now that the SBA and the Financial Assistance programs are no longer proposed to be eliminated, loan levels should come back up a little.

d. Officials from SBA met with officials from the Department of Commerce, the Minority Business Development Agency and the Office of Management and Budget on Wednesday, March 18. The purpose of this meeting was to identify issues and problems raised by the transfer proposal and to reach agreement on how the proposal could best be implemented. This was the first of many meetings that will be held to formulate a plan for implementing the transfer as of October 1, 1987.

Further details of plans and discussions will be made available to the Committee as developed.

PART OF ATTACHMENT

RESPONSE TO "GUARANTEED LOAN PROGRAM CHANGES, Question #1.

ALTERNATIVE SOURCES FOR LOAN GUARANTEES

A Report to Congress

By The

U.S. Small Business Administration

June, 1986

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COSTS AND REVENUES

We now turn to a discussion of the costs of the 7(a) Guaranty Program and the revenue which it brings in. The costs and revenues associated with the 7(a) program are displayed in Table 1. A technical explanation of the calculations is contained in Appendices 2 - 4.

Costs

There are in general two categories of cost associated with the program. The first is administrative cost, which includes all direct and indirect administrative expenses involved in both loan making and portfolio management. Analysis reveals that the cost of administering the program averages 2.6 % of the guaranteed amount of a loan. (This figure is based on the present value of direct and indirect costs of loan making and loan servicing, as estimated in a 1981 SBA program cost allocation study. It assumes a given average loan size. Since the cost of administration is directly related to the number of loans being administered, as average loan size changes the corresponding cost of administration as a percentage of SBA guaranteed amount will change as well. In dollars, based on current information, the SBA cost of servicing a guaranteed loan is $135 per year. The estimated SBA cost of making a guaranteed loan is $1,350. The cost of making and servicing direct and disaster loans would be considerably higher.)

A second category of cost is the loss rate on loans. The sequence of events that gives rise to a loss on a loan is this: a borrower falls behind on his payments by sixty days or more; the lender requests SBA to purchase the guaranteed portion of the loan; SBA makes the purchase; efforts to make

Table 1

Present Value of Income and Expenses
in the 7(a) Guaranteed Business Loan Program
(as % of Guaranteed Amount)

Expenses		
Cost of Administration		2.6%
Ultimate Loss Rate on Loans		
Historical	7.8	
Recent	3.2 to 4.8	
Total Cost		
With Historical Loss Rate		10.4
With Recent Loss Rate		5.8 to 7.4
Revenues		
Guaranty Fee		2.0
Annual Fee on Outstanding Loan Balance		
0.25% Fee	0.9	
1.00% Fee	3.7	
Total Revenue		
Guaranty Fee Only		2.0
Guaranty Fee & 0.25% Fee		2.9
Guaranty Fee & 1.00% Fee		5.7

NOTE: As these figures are based on discounted present value calculations over the lifetime of a typical loan, they are not directly transformable into annual appropriation figures.

The figure for cost of administration as percent of guaranteed amount is based on the present value of direct and indirect costs of loan making and loan servicing, as estimated in a 1981 SBA program cost allocation study. It assumes a given average loan size. Since the cost of administration is directly related to the number of loans being administered, as average loan size changes the corresponding percentage cost of administration will change as well.

In dollars, based on current information, the SBA cost of servicing a guaranteed loan is $135 per year. The estimated SBA cost of making a guaranteed loan is $1,350. The cost of making and servicing direct and disaster loans would be considerably higher.

the loan viable are ultimately unsuccessful; and the loan must be liquidated. In liquidation every effort is made to minimize loss through sale of collateral and collection from guarantors of the loan. In this report losses are defined as the cost of loan purchases less proceeds from liquidation, all expressed as a percentage of the SBA guaranteed portion of loan disbursements. SBA uses a concept of "ultimate loss rate," which counts both the losses actually incurred to date plus an estimate of losses expected to occur in the future on loans already disbursed.

For loans made in any given year, losses are distributed over the lifetimes of the loans made in that year. For example, losses on loans made in 1986 will occur in 1987, 1988, and so on. In this analysis, in order to be able to compare the value of costs and revenues that occur at different points in time, all values have been converted to their discounted present value.

The present value of the ultimate loss rate over the lifetime of the 7(a) guaranteed business loan program is 7.8 % (Appendix 2). (This is the present value of an estimated ultimate loss figure of 12.1 %, as calculated by the SBA Office of Accounting Operations as of Sept. 30, 1984.) These losses have occurred on loans disbursed over a period of twenty-eight years, which have encompassed several complete business cycles and a variety of attitudes toward risk that reflected the prevailing political sentiments of the day.

In the last four years, this Administration has tightened underwriting standards and emphasized a "quality lending" approach to loan making. In addition, the last three years have been a period of sustained economic expansion. Research by the Office of Financial Assistance provides some evidence that ultimate loss rates on loans made in 1983 and 1984 are below the historical average. While the loss projections on loans made so recently are not precise enough to state their ultimate values with certainty, they appear to be in the range of 3.2% to 4.8 %. (These are the present values of ultimate loss estimates of 5% to 7.5%, as calculated by the SBA Office of Financial Assistance. It should be emphasized that the accuracy of the prediction model increases as the year of approval grows more distant. Loans approved in 1983 and 1984 have only been "aged" for one and two years respectively. For further explanation please see Appendix 3.)

Revenues

With the enactment of P.L. 99-272, the guaranty fee on 7(a) loans was increased from 1 % to 2 % of the guaranteed amount of the loan. This is a one-time up front fee that is paid by the borrower at the time the loan is disbursed. Consequently, it it raises revenue equal to 2 %.

Impact of an Annual Fee on the Unpaid Balance of Loans

SBA was asked in this report to estimate the impact of an annual fee of between one-quarter of one percent and one percent of the value of the unpaid balance of any loan made under the program. Taking the typical SBA loan, the present value of the series of annual payments that SBA would be entitled to receive over the lifetime of the loan comes to 3.7 % of the guaranteed amount of the loan with a one percent fee. If the fee were set at one quarter of one percent, the payments would amount to 0.9 % (Appendix 4).

Could such revenues be used to defray the cost of administration of the program? An annual fee of one quarter of one percent added to the two percent guaranty fee could produce revenue of 2.9 % and could, other things being equal, cover the 2.6 % cost of administering the 7(a) program.

However, collecting the fee could itself add significantly to the administrative cost of the program. SBA had experience with such a system from the beginning of the guaranty program through 1974. It proved very costly to administer. The fees were difficult to collect and many of the accounts receivable had to be written off. Finally a task force recommended that the then-existing annual fee of one-quarter of one percent be replaced by a one-time up-front fee of one percent. That is how the present guaranty fee came to be adopted.

Could the fee be used for a loss reserve fund? A one percent annual fee combined with the two percent guaranty fee would yield income of 5.7 %. Whether this would be sufficient to cover losses on loans depends upon the future loan loss rate. If it continues at its historical rate of 7.8 %, the fees would cover 73 percent of the losses. If the current reduced loss rate--estimated to be in the range of 3.2 to 4.8%--were to continue, then the fees would be more than sufficient to cover losses; there would be something left over to defray part or all of the administrative costs as well.

Under Section 4(c)(2) of the Small Business Act, receipts from any fee that might be imposed on outstanding guaranteed loan balances are to be paid into the Business Loan and Investment Fund. Thus they would be available as a loss reserve or to defray administrative expense.

However, as the revenue and expense figures in this section have been stated in terms of their discounted present value, SBA deposits at the Treasury would have to earn interest in order for the fees to relate to expenditures in the way presented in this section. Presently such deposits do not earn interest.

OPPORTUNITIES FOR LOSS REDUCTION: CAN THE PROGRAM BECOME SELF-FINANCING?

What are the prospects for making the 7(a) loan guaranty program self-financing? Let us first examine the determinants of losses and the opportunities for loss reduction. Losses in the loan guaranty program are a function of four sets of factors:

- Federal Program Policy regarding inherent risk;
- The efficiency with which the program is designed and run;
- The level of program revenue; and
- The economy.

Inherent risk. Program policy toward the inherent risk embodied in SBA guaranteed loans has shown considerable variation over the history of the program. Since program inception SBA field offices have shown themselves flexible in their implementation of the program and responsive to changes in risk policy signalled by the President and the Administrator. During the past four years a "quality lending" approach has been in force, emphasizing high underwriting standards and a reduction of loss. As cited above, this--together with expansion of the economy--appears to have led to a reduction in likely losses for loans made in the past two years. Attention to policy toward loss is likely to be a fruitful area on which to focus any effort to reduce losses. For example, lenders could be charged a guaranty fee that varies directly with the loss rate on their loans. However, built into any such policy is an inherent conflict at some point between further reduction of losses and SBA's role of lending to small businesses that are unable to obtain credit elsewhere.

One way to implement a policy of further inherent risk reduction is to lower the guaranty percentage. An analysis of guaranteed loans made between FY 1974 and the first quarter of FY 1985 revealed that loans with a guaranty of 70% to 80% had a chargeoff rate 16% lower than loans with a 90 % guaranty. (Appendix 2)

Operating Efficiency. By operating efficiency is meant the reduction in loss for a given level of inherent risk by more efficient loan servicing. It should be possible to reduce losses by increasing the intensity of loan servicing, e.g. by reacting more quickly to early warning signs that a borrower is in trouble, by more intensive counseling and other assistance to problem cases, by stepping in more quickly to protect collateral, and by speedier disposition of cases in liquidation.

Another possibility is to modify the nature of the guaranty. At present, SBA guarantees to lenders that it will purchase the outstanding balance plus accrued interest on the guaranteed portion of loans on which borrowers have fallen behind in their payments by sixty days or more. A different approach would be for SBA to guaranty lenders that it will reimburse them for a percentage--85 % for example-- of their losses on loans after all efforts to collect, including liquidation, have been exhausted. This approach would give lenders a greater incentive to monitor loans closely and to collect as much as they can if a loan goes into liquidation. A bank would keep 100 % of what it collects in liquidation, and be reimbursed by SBA for 85 % of any loss after liquidation. Under the current system, the bank would be reimbursed for 85 % of its loss when SBA purchases the loan and would keep only 15 % --the unguaranteed portion--of any amount it may collect in liquidation.

Program Revenue. In this report we have discussed new and different sources of revenue such as insurance premiums and fees on the outstanding balance of guaranteed loans. Another possible source of new revenue would be to impose application, guaranty and other fees in connection with SBA's secondary market guaranty. In levying such fees, consideration should be paid to possible effects on program participation.

The economy. The economy is a most important determinant of loss. In recession years and in periods of high interest rates the risk of default on SBA-guaranteed loans increases. A recent study by SBA's chief actuary shows a significantly higher rate of purchase on guaranteed loans in the recession period of 1980-1982 than in the period 1969-1978. Interestingly enough, the ratio of losses to purchases is about even during the two periods, a fact that the chief actuary attributes to the effort of the SBA collection personnel. In any policy toward loss reduction, the state of the economy is a factor to be reckoned with, but one that is beyond the influence of the SBA.

Can the Program Become Self-Financing?

An important SBA policy issue of the day is whether the 7(a) guaranty program can become self-financing. The SBA budget reflected in the FY 1987 Congressional Budget Resolution, as reported in the Senate, is based upon the assumption that the program would become self-supporting starting in fiscal year 1987. This means, according to the report of the Senate Budget Committee, that "program income would have to cover administrative and default expenses on loans guaranteed after that year." How might this be achieved? "The Committee assumes that the goal of a self-financing program could be achieved through steps such as raising fees, delegating more responsibility to lenders, tightening underwriting standards, and reducing the amount of government liability on each loan guaranteed." (Senate Report 99-264, March 24, 1986, p. 81.)

We first examine the extent to which fees might cover losses. The figures in Table 1 indicate that the present value of ultimate losses ranges from a low of 3.2% under the most optimistic scenario to a high of 7.8% under the most pessimistic. Under current law the guaranty fee brings in income equal to 2.0%. An additional one percent fee on the outstanding loan balance would raise total revenue to 5.7% and would cover 178% of losses under the most optimistic scenario, but only 73 % of losses under the most pessimistic forecast. What policies can SBA follow to move the program toward covering losses?

1. SBA can continue to perfect its quality lending approach to loan making by placing greater emphasis on the adequacy of collateral (with more weight given to providing long term credit as the major program goal or rationale). It should be

recognized, however that under such a policy some borrowers that heretofore would have qualified for a loan guaranty would no longer be eligible.

2. The nature of the guaranty can be changed from a "purchase" guaranty to an "indemnification" guaranty. (Please see discussion in preceding section.) This change should result in closer loan monitoring by lenders and greater incentives for lenders to collect on loans in liquidation. It can also be expected to reduce SBA's portfolio management costs (one of the elements of cost of administration).

3. The loans can be serviced more intensively. This step would include the closer monitoring referred to above, watching for early-warning signs that a borrower may be encountering difficulty, stepping in with counseling assistance in such cases, and taking faster action to protect collateral when problems develop. This policy would require additional government resources. These could take the form of additional SBA personnel to oversee bank servicing activities in a more thoroughgoing manner or of contracting this function out to the private sector. There is research evidence that management assistance by either the lender or SBA decreases the probability of default in 7(a) guaranteed loans. (William C. Hunter, "Moral Hazard, Adverse Selection and SBA Business Loan Guarantees," in Conference on the Economics of Federal Credit Activity, Congressional Budget Office, September, 1981, Part II, p. 267).

4. Fees could be increased, either by raising further the existing guaranty fee or by placing a levy on the outstanding balance of the guaranteed portion. The latter, however, may significantly increase administrative cost due to collection difficulties. (See discussion above.) Fees could also be based upon historical loan loss: the fee could vary with the lender's own loss record, with the loss record in the SBA district, or based upon SIC code. In this way riskier loans would pay greater fees.

5. New secondary market fees could be imposed. These could take the form, for example, of a fee from investors in exchange for receiving holder in due course status when they purchase an SBA-guaranteed loan portion and a fee from pool assemblers in exchange for the SBA guaranty of timely payment of principal and interest on pool securities.

There are many unknowns in adopting the preceding set of policies. Future loss rates cannot be known with certainty. Will they be as low as current predictions indicate? Or will they rise to historical levels? Because the economy plays such an important role in influencing loss rates and because it is so difficult to predict the future course of the economy, we cannot say for sure. What will be the effect on program demand of higher credit standards and higher fees? We know what the direction will be: reduced demand. But we don't know the magnitude.

Any program modifications should be flexible to prohibit undue disruption and allow for necessary mid-course corrections.

A proper phase-in would be vital to a successful test of the policy. The delivery system for the loan guaranty program involves many participants: borrowers, lenders, secondary market broker-dealers and investors, and the SBA. SBA would need to undertake a major educational and communications effort: to explain the changes, to allay fears and possible misconceptions, and to receive feedback from participants. As the results come in, changes may be necessary. SBA must be able to act quickly to modify course if necessary.

The design of a phase-in should be forward-looking. For example, it should reflect the fact that new fees cannot be applied retroactively: a fee on outstanding loan balance could be levied on loans made on or after the date of implementation, but not before. Costs associated with loans made in the past therefore could not be covered. And it will take time for the effects of many of the policy changes to be felt.

SBA makes no recommendations with regard to the adoption of any of the options discussed in this report. However, the agency stands ready to discuss with the Congress the issues raised herein.

APPENDIX 1

Section 18010 of Public Law 99-272

SEC. 18010. REPORT CONCERNING ALTERNATIVE SOURCES FOR LOAN GUARANTEES.

Not later than June 30, 1986, the Administrator of the Small Business Administration shall submit to the Committees on Small Business of the Senate and the House of Representatives an internal report concerning—

(1) the options available to provide a guarantee on loans under section 7(a) of the Small Business Act from sources outside the Federal Government, together with such recommendations as the Administrator may have with respect to such options, including an evaluation of the feasibility of establishing a corporation owned by the Federal Government to make such guarantees; and

(2) the imposition, on each participating lender in the guaranteed loan program under section 7(a) of the Small Business Act, of an annual fee of between one-quarter of one percent and one percent of the value of the unpaid balance of any loan made under such program, particularly on the revenues that could be expected and whether such revenues could be used for a loss reserve fund or to defray the cost of administration of the program.

APPENDIX 2

COST REDUCTION IN THE 7(a) GUARANTEED LOAN PROGRAM: AN ANALYSIS OF OPTIONS

(Note: This analysis was conducted by the Office of Finance and Investment, with the assistance of the Office of the Comptroller.)

I. METHODOLOGY

This paper will examine two options for reducing governmental costs in the SBA 7(a) loan guarantee program: increasing the fee paid as a percentage of the amount guaranteed (currently 1%) and lowering the guaranty percentage. The exercise of such options, by increasing the price of the guaranty, would probably tend to dampen demand. However, the measurement of such effects is beyond the scope of this paper.

Income and costs in the program can be grouped into the categories shown in Table 1.

In order to most clearly show the effects of varying the guarantee fee and the guaranty percentage, figures in the income and expense categories in Table 1 were calculated on the basis of cents per dollar of guaranteed amount or cents per dollar of loan amount. For example, the guarantee fee currently is 1¢ per dollar of guaranteed amount.

With reference to Table 1, the rationale for the assumptions regarding the time periods during the life cycle of a loan in which each of the cost and income categories occurs (e.g., during the first year, during all 9 years, etc.) is as follows:

- Guarantee fee is a one time fee paid at time of settlement, and therefore occurs in year 1 only.
- Interest income is income from purchased loans and would be a recurring event. Normally, this income would be offset against the interest expense on borrowings from Treasury. However, since data for the latter were not available as a unique allocation to the 7(a) program at the time this analysis was conducted, the assumption was made for the purpose of this analysis that the two are offsetting. The analysis will be recomputed at an early date to explicitly include interest income and expense as soon as the necessary data are available.
- Salaries and Administrative expenses are one-time costs associated with loan making and occur during the first year only.
- Portfolio management is a recurring cost through the life of the loan.
- Losses: The Office of the Comptroller has compiled data indicating that purchases of loans occur during the first 7 years of the typical loan cohort's life as shown in Table 2.

TABLE 1

INCOME AND EXPENSE CATEGORIES IN THE 7(a) LOAN GUARANTY PROGRAM

INCOME	YEAR(S) OF OCCURRENCE[3]
Guarantee fees	1
Interest income[1]	1-9
DIRECT EXPENSES	
Salaries and administrative[1]	1
Portfolio management[1]	1-9
INDIRECT EXPENSES	
Personnel, financial management legislative, executive, auditing, investigative, computer, legal and miscellaneous services.[1]	Half=1 Half=1-9
INTEREST EXPENSE TO TREASURY	1-9
ULTIMATE LOSSES ON LOANS[2]	1-7

[1] Data for these items is from Office of the Comptroller, "Program Costs, Fiscal Year 1981."

[2] Data is from Office of Accounting Operations, "FY 1984 Loss Rates." Ultimate losses at any point in time are defined as total actual and estimated future losses divided by total disbursements.

[3] Year 1 is the year in which the loan is made. Year 2 is the year after the loan is made, etc.

NOTE: The cost of the direct and indirect expense items is calculated as follows: The Office of the Comptroller has estimated the total dollar cost of these items in fiscal year 1981 for each of SBA's major programs (see footnote 1). For the costs that occur only in year 1, cost per dollar of guaranteed loan amount is derived by dividing total program cost by the program level for guaranteed loans in FY 1981. The SBA share of $2.8 billion is used in Tables 3 and 5. The total loan amount of $3.2 billion is used in Tables 6 and 7. The recurring costs arise to service the entire 7(a) guaranteed loan portfolio, rather than the loans made in any one year. Therefore, the recurring costs per dollar of guaranteed loan are derived by dividing by the figure for the total 7(a) portfolio in FY 1981. The figure for SBA share ($8.78 billion) is used in Tables 3 and 5. The figure for total loan amount ($9.98 billion) is used in Tables 6 and 7. This figure was relatively constant over this period: $9.0 billion in 1982, $8.8 billion in 1983, and $8.9 billion in 1984. The average life of an SBA loan is 9 years.

TABLE 2

YEAR	Of loans that are purchased % that are purchased in each year
1(year loan is made)	1.43
2	13.36
3	19.95
4	31.18
5	18.23
6	9.96
7	5.89
	100.00

Liquidation generally is completed in the year following purchase; therefore, the occurrence of losses was lagged one year behind the year of purchase. For example, 1.43% of the losses are assumed to occur in year 2 of our typical loan cohort's life (one year after the loans in the cohort are made).

- Interest Expense to Treasury: See discussion under interest income.

- Indirect Expenses are allocated half during the first year and half as recurring expenses over the life of the loan, as these support both the first year loan making activity and the ongoing portfolio management activity.

Since this is a multi-year analysis, all income and expense figures used below are present value, using an 11.78% discount rate (the 5 year average yield on 10 year Treasury securities, 1979-1983).

II. INCOME AND EXPENSES IN THE 7(a) LOAN GUARANTEE PROGRAM PER DOLLAR OF GUARANTEED AMOUNT

With the preceding data sources and methodology, the basic income and expense figures of the 7(a) loan guarantee program are as shown in Table 3.

The present value of the program's net cost per dollar of guaranteed amount, counting direct expenses, indirect expenses, ultimate losses on loans and a 1% guaranty fee is 9.44¢. With a 3% fee the cost would decline to 7.44¢, and would decline further to 5.44¢ with a 5% fee.

III. IMPACT UPON SMALL BUSINESS BORROWER

The impact upon the small business borrower is most graphically measured by assuming that the increase in fees is financed by increasing the size of the loan by an amount equal to the fee, and then noting the resulting percentage increase in monthly payments. It is a common practice in many financial sectors to finance up-front fees or "points" in this way. For a typical SBA loan the percentage increase in monthly payments for a 3% fee would be 1.73% (Table 4). The increase would be 3.42% for a 5% fee. While such increases are by no means insignificant, they should not be prohibitive.

TABLE 3

Income and Expenses Compared to Guaranty Amounts

Income and Expenses	Present Value per dollar of Guaranteed Amount
	¢
Income	
Guaranty Fee	1.00
Direct Expenses	
Salaries and Administrative	.42
Portfolio Management	1.77
Indirect Expenses	.45
Ultimate Loss	7.80[1]
Net Income or (Program Cost)	(9.44)
With 3% fee	(7.44)
With 5% fee	(5.44)

[1] This is the present value of an estimated ultimate loss figure of 12.1¢, as calculated by the Office of Accounting Operations as of Sept. 30, 1984. The estimate is based upon historical experience, which may or may not be an accurate forecast of future losses.

TABLE 4

Impact Upon Borrower of Increasing Fees

Fee	Loan Size ($)	Monthly Payment ($)	% increase in Monthly Payment compared to 1% Fee (%)
Current 1% fee	171,063	2,719	
3% fee	173,971	2,766	+1.73
5% fee	176,879	2,812	+3.42

NOTE: Calculations assume:

1. Fee increase financed by increasing loan size by amount equal to fee increase.

2. Loan size = average guaranteed loan size in FY 1984.

3. Term = 9 years, average term for 7(a) guaranteed loans

4. Interest rate = 13.25%, composed of 10.5% (New York prime on February 6, 1985)+ 2.75% maximum allowable add on.

IV. EFFECT OF DECREASING THE GUARANTY PERCENTAGE

Currently the average guaranty percentage for guaranteed loans is 88%. (Office of the Comptroller) Lowering the guaranty percentage to 70 percent would, by itself, have no affect upon ultimate losses per dollar of guaranteed amount, although it would, as we see below, have a significant effect upon losses per dollar of loan. However, a comparison of charge off rates (charged off SBA amount divided by disbursed SBA amount) between loans with a 90% guaranty and loans with a 70 - 80% guaranty reveals that loans in the latter category have chargeoff rates 16.3% lower than the 90% loans. This is consistent with the expectation that the lower the guaranty percentage the higher will be the loan quality, since the private sector lender is assuming more of the risk. (The analysis was performed on loans made from Fiscal Year 1974 through the first quarter of FY 1985.) Data were not available to calculate the difference in the ultimate loss rate (chargeoffs minus recoveries divided by disbursements) between the 90% and the 70 - 80% loans. However, there is no reason to believe recoveries would be greater on 90% loans than on 70 - 80% loans; if anything, recoveries might be greater on the latter because of increased loan quality. In the current analysis, therefore, a 16.3% reduction in the ultimate loss rate is assumed as a result of a decrease to a 70% guaranty.

The effect of this reduction is to lower the net cost to 8.17¢ per dollar if the current 1% fee structure is retained. If fees are increased to 3%, the cost would fall further to 6.17¢ and at 5% the cost would be 4.17¢. (Table 5)

V. INCOME AND EXPENSES PER DOLLAR OF LOAN AMOUNT

Another way to analyze the income and expenses in the 7(a) guarantee program is to look at these magnitudes per dollar of loan amount, as opposed to guaranteed amount. To illustrate, in a $100,000 loan carrying a 90% SBA guarantee, $100,000 is the loan amount and $90,000 is the guarantee amount. Looking at cost per dollar of loan amount is especially important for policy analysis, as it gives a measure of the impact upon the small business sector and upon the economy for given amounts of governmental expenditure as important elements of program design such as fees and guaranty percentages are varied.

The analysis is in most respects the same as that in sections II-IV, except that costs and income are expressed in terms of cents per dollar of loan rather than cents per dollar of guaranteed amount.

Effect of lowering percentage guaranty to 70% upon Net Cost Per Dollar of Guaranteed Amount

Fee	Net Cost
	¢
1%	8.17
3%	6.17
5%	4.17

As Table 6 shows, net cost declines to 8.31¢ per dollar. If fees are raised to 3 or 5 percent, cost per dollar declines to 6.55¢ and 4.79¢ respectively. These costs are about 12% below the corresponding costs per dollar of guaranteed amount, as total loan amount is 12% greater on average than guaranteed amount.

VI. EFFECT OF LOWERING GUARANTY PERCENTAGE ON COST PER LOAN DOLLAR

Lowering the guaranty percentage has both a direct and an indirect effect upon cost per loan dollar. The direct effect is that the ultimate loss rate falls because the percentage guaranty of the typical loan is 70% rather than 88%. Secondly, as explained above in Section III, it is assumed in this analysis that the ultimate loss rate falls by an additional 16.3%, based upon both theoretical expectation and empirical observation.

The present value of the ultimate loss rate falls by 1/3, from 6.86¢ per dollar to 4.57¢. Approximately 60% of this change is due to the direct effect and 40%, to the indirect effect.

The present value of net program cost falls to 6.2¢ per dollar with the current one percent fee, to 4.8¢ with a 3% fee and to 3.4¢ with a 5% fee. (Table 7)

VII. SAVINGS IN BUDGET AUTHORITY AND OUTLAYS

The present value of budget authority and outlay savings can be calculated directly from the tables. For example, the savings per dollar of loan amount that can be realized by switching from the current policy to a 70% guaranty rate and 5% fee are as follows:

Net Program Cost per loan dollar under current policy (Table 6)	8.31¢
Less Net Program cost per loan dollar with 5% fee and 70% guaranty (Table 7)	-3.40¢
Savings	4.91¢

The savings are 4.91¢ per loan dollar or $49,100,000 per billion dollars in loans. The actual year by year outlay savings can be calculated by converting back from present value to undiscounted dollars.

TABLE 6

Income and Expenses Compared to Loan Amounts

Income and Expenses	Present Value per dollar of Loan Amount (¢)
Income	
Guaranty Fee	.88
Direct Expenses	
Salaries and Administrative	.37
Portfolio Management	1.56
Indirect Expenses	.40
Ultimate Loss	6.86
Net Income or (Program Cost)	(8.31)
With 3% fee	(6.55)
With 5% fee	(4.79)

Note: The average guaranty percentage in the 7(a) guaranteed loan program is 88%. Therefore, a 1% fee, per dollar of loan amount, equals .88¢.

TABLE 7

Income and Expenses Compared to Loan Amounts with 70% guaranty

Income and Expenses	Present Value per dollar of Loan Amount (¢)
Income guaranty fee	.70
Direct Expenses	
Salaries and Administrative	.37
Portfolio Management	1.56
Indirect Expenses	0.40
Ultimate Loss	4.57
Net Income or (Program Cost)	(6.20)
With 3% fee	(4.80)
With 5% fee	(3.40)

APPENDIX 3

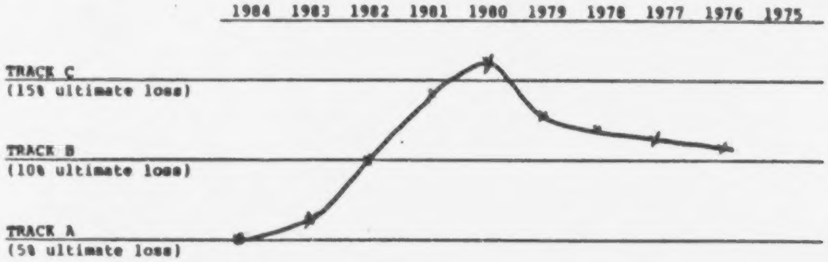
The following schedule shows dollars charged off by year of approval for the ten-year period from 1975 through 1984 for 7(a) business loans. Disaster loans are excluded. Again, it should be emphasized that these statistics cannot be used for comparisons with the losses of private sector lenders because of the lack of consistency in the definition of terms and statistical measurements.

Dollars in Millions

	1984 (yr. 1)	1983 (yr. 2)	1982 (yr. 3)	1981 (yr. 4)	1980 (yr. 5)	1979 yr. 6)	1978 (yr. 7)	1977 (yr. 8)	1976 (yr. 9)	1975 (yr. 10)
Dollars Disbursed	2,945.4	2,484.7	1,720.8	3,041.8	3,255.3	2,961.4	2,786.8	2,555.0	1,799.9	1,441.8
Dollars Charged off	5.2	23.2	58.7	244.4	329.4	260.3	246.0	221.7	169.8	142.2
Percent	.2	.9	3.4	8.0	10.1	8,8	8.8	8.7	9.4	9.9

This schedule shows charge-offs by year of approval as of 9/30/85. No provision is included for eventual losses. A performance model has been constructed so that interim loan statistics can be used to predict ultimate charge-off rates. An ultimate charge-off rate is the percentage that will eventually occur after all the loans approved in a given year are either repaid or charged off. Use of the model shows a steady improvement in SBA charge-offs since the quality lending initiative was launched by the Agency during 1981. (See Exhibit I for the Performance Model.) FY 1982 is the first full year under the quality lending initiative.

The following predicts SBA charge-off performance by year of approval.



Accuracy of the model increases as the year of approval grows more distant. Still, the trend of improvement is consistent and encouraging. Predicted SBA losses have been reduced by more than two-thirds since FY 1980 according to the above.

NOTE: The discrepancy between the loss rates for 1983 and 1984 given in this appendix and the 3.2 % to 4.8 % figures used in the text of the report is due to the latter being stated in present value terms.

EXHIBIT I

I. PERFORMANCE MODEL

Charge-off Rate Patterns for SBA Field Offices

Ultimate Charge-off Range	Year One	Year Two	Year Three	Year Four	Year Five	Year Six	Year Seven	Year Eight	Year Nine
TRACK A	.2 (0-.3)	.6 (.2-.9)	1.1 (.7- 1.6)	1.6 (1.2-2.0)	2.1 (1.8-2.4)	2.8 (1.4-4.1)	3.0 (1.7-4.3)	3.1 (2.2-4.0)	3.3 (2.3-4.3)
TRACK B	.5 (0-1.1)	1.9 (.8-3.0)	3.4 (2.4-4.5)	5.0 (4.4-5.6)	5.9 (5.6-6.2)	6.9 (6.0-7.7)	7.4 (6.2-8.6)	7.9 (6.3-9.5)	8.4 (6.6-10.1)
TRACK C	.7 (0-1.6)	2.5 (1.2-3.9)	4.8 (3.4-6.3)	7.6 (6.5-8.7)	9.7 (9.3-10.0)	11.0 (10.1-11.9)	12.0 (11.3-12.7)	12.1 (11.4-12.8)	12.6 (11.8-13.3)

TRACK A charts the path for loans with ultimate charge-off rates of approximately 5%; TRACK B charts the path of loans in the 10% range, and TRACK C does the same for the 13% to 15% range. As an example, the average third year charge-off rate for the 5% path (TRACK A) is 1.1%. The parenthesis below the 1.1% shows the spread of one standard deviation, which in this case ranges from .7% to 1.6%. A standard deviation is defined as a range within which 68% of the sample will fall. This means that 68% of TRACK A third year charge-offs will fall within the range of .7% to 1.1%. By doubling the spread to two standard deviations (.5 to 1.3), 99% of the charge-offs will fall within the range.

Field Offices can use the PERFORMANCE MODEL to predict the ultimate rate based on interim performance as follows:

Example 1

For an office having a fourth year charge-off rate of 5.2%, the user should find "year four" on the model, read down to find the range that includes the 5.2% rate, and then read to the left margin to identify the track (TRACK B in this example). Thus, our model indicates that offices showing a 5.2% failure rate at the end of four years can expect an ultimate failure rate of approximately 10%.

Example 2

A sixth year charge-off rate of 9% falls about midway between TRACK B and TRACK C. By reading to the left, the schedule indicates that ultimate performance will fall in the range between 10% and 15%.

Year one includes approvals that are 12 months to 24 months old, Year two loans are 24 months to 36 months old, and so on. The columns are labeled to align with the PERFORMANCE MODEL for ease of reference.

APPENDIX 4

Calculation of Outstanding Balance over Time on Average SBA Loan

Section 18010 of P.L. 99-272 requires a calculation of the revenue that would be raised by an annual fee of between one-quarter of one percent and one percent of the value of the unpaid balance of any loan made under the 7(a) guaranteed loan program. Such a calculation requires two steps:

- Computation of the outstanding balance during each year of the life of a typical SBA loan.
- Computation of the present value of the sum of such outstanding balances.

The following assumptions were made:

1. Interest rate. The interest rate used in the calculations was 11.21 %, the median rate on guaranteed loans in fiscal year 1986 through the month of April.
2. Constant prepayment rate. SBA loans may be prepaid due to voluntary prepayments by borrowers or due to purchase by SBA as a result of borrower defaults. There is no prepayment penalty on 7(a) loans. The Public Securities Association has recently analyzed SBA data and found a 6 % average prepayment rate on variable rate loans. This means that, on average, 6 % of the balance outstanding on such loans at the beginning of any one year will be prepaid by the end of that year. In the present calculations, this effect was accounted for as follows. To calculate the outstanding balance at the beginning of year two, subtract, from the balance given in the amortization schedule, 6 % of the outstanding balance at the beginning of year one. The same procedure is followed each year until maturity.
3. Maturity. The maturity was assumed to be nine years, which is the average maturity of a 7(a) guaranteed loan.
4. Discount rate. The discount rate used in the present value calculations was 11.78 %, which is the five year average yield on 10 year Treasury securities from 1979 - 1983.
5. It was assumed that the fee would be applied annually to the beginning of year balance.

With these assumptions, the present value of the sum of the outstanding balances over the life of the loan came to 3.74 times the loan amount. One percent of this factor is 3.74 % of loan amount; one quarter of one percent is 0.94 % of loan amount.

ANSWERS TO WRITTEN QUESTIONS SUBMITTED TO CHARLES HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, FROM HON. JOSEPH M. MCDADE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

MINORITY PROGRAMS

A. Transfer of MBDA to SBA

Questions:

The FY 1988 budget proposes transfer of the Minority Business Development Agency from the Department of Commerce to SBA.

1. What are the total costs associated with this transfer?

2. Will MBDA personnel be transferred along with program and activity functions?

3. What, if any, will be the personnel impact of this transfer?

4. Under this consolidation plan, how will programs be strengthened to better serve the needs of the minority community?

Answers:

1. Exact costs have not been determined. However, we feel that adequate amounts of funds have been provided within the various administrative expense object classes to absorb the cost of this transfer.

2. MBDA personnel required to ensure adequate support and continuity of transferred program activities and functions will also be transferred to SBA. The proposed budget calls for transfer of 140 full-time equivalent (FTE) positions to SBA.

3. The impact on individual personnel cannot be assessed until all new organization structure alternatives are fully explored and it is determined what specific positions will be established at SBA to carry out the transferred functions. The Department of Commerce will try to minimize adverse impact and will respect the rights of all employees. At this time, we do not anticipate any adverse effects on present MSB&COD employees.

4. Through consolidation of resources, a more coordinated, consistent and focused effort to promote minority business development can be achieved. The needs of the minority community will be better served because:

   -- The consolidation will permit closer linkages between SBA's procurement and financial assistance programs and the MBDC clientele.

- -- MBDCs will provide SBA with a more significant presence in the minority communities. Minority businesses will be able to obtain complete, up-to-date and non-conflicting information about small and minority assistance programs from a single agency.
- -- Because SBA's entire mission is focused only on providing business assistance, by locating minority assistance programs in SBA, minority business concerns will not have to compete for attention and support with a large number of other interests, as in the case within the Department of Commerce--a Governmment Agency dealing with matters ranging from satellites to statistical methodology.
- -- Lastly, in addition to making the existing minority business assistance programs more responsive to the concerns of the minority business community, the consolidation of minority business programs will have a long-term positive effect on future direction of Federal minority business policy and programs.

B. Elimination of Direct Loans for Minorities

Question:

Please provide for the record a complete listing of the number of applications for direct loans submitted to SBA by minorities and the number approved by the agency from 1984 to the present.

Answer:

Information regarding applications by program area is retained in SBA's computer database for only a ninety-day period. Therefore, we are unable to provide information regarding the number of applications for such loans received by SBA during that three-year period. The number and the amount in direct loans approved by SBA from 1984 to present is as follows:

Minority Direct Loan Approvals
Fiscal Years 1984 - 1986

(Dollars in Millions)

Year	Number	SBA Amount
1984	749	$ 45.5
1985	699	38.3
1986	214	11.6
1987 Y.T.D. (Feb.)	98	5.6
Total	1,760	$ 101.0

BUSINESS LOAN PROGRAMS

Questions:

1. The FY 1988 budget request recommends the consolidation of all guaranteed credit programs into three major programs. What savings, if any, could be realized from this consolidation? Would this proposal necessitate reductions in personnel?

2. Please provide for the record a complete listing of the number of applications submitted to SBA for direct loans by handicapped individuals and veterans and the number approved by the agency from 1984 to the present.

Answers:

1. The reason for making this proposal is not the need to achieve budgetary savings but to reduce the confusion that exists in the small business community over SBA's business loan programs. Thus, implementation of this proposal would have no effect on personnel requirements. The basis for the consolidation proposal is that under existing law SBA has authority to make loans to the following categories of borrowers:

   1. To any qualified small business concern.

   2. To any small business concern owned by a low--income individual or located in an area with high proportions of low income or unemployed individuals.

   3. To any small business concern in the energy business.

   Categories two and three are subsets of category one. Any loan that SBA can make to a category two or category three borrower, it can make under the category one authority. It has been the agency's experience that loan applicants hear that SBA has special loan programs for energy and for economic opportunity and presume that they are really different and "special" and then we must explain to them that these programs have identical applications requirements, interest rates, terms and conditions and that even the credit criteria are very similar. Government's credibility can be seriously impaired by continuing to present to the public a set of distinctly--named programs that are in fact identical.

   Existing law also provides a separate authority for loans to public or private organizations for the handicapped or to assist any handicapped individual in establishing, acquiring, or operating a small business concern.

   SBA's proposal would integrate these three separate authorities into the general business loan authority. All classes of borrowers that are eligible under current law would continue to be eligible under the bill.

It is not sound policy for the law to require SBA to maintain separate programs that are separate in name only. Their combination would be prudent and easily accomplished. SBA will, however, maintain the necessary emphasis on the needs of these special classes of borrowers and the ability to continue to report on lending activity by each category of borrower, even though the financing would be provided under the broad category of "General Business."

2. Information regarding applications by program area is retained in SBA's computer data base for only a ninety-day period. Therefore, we are unable to provide information regarding the number of applications for Handicapped and Veteran loans received by SBA during that three-year period. The number and the amount of direct loans approved by SBA from 1984 to present is as follows:

Handicapped and Veteran Loan Approvals
Fiscal Years 1984 - 1986

(Dollars in Millions)

Handicapped Assistance Loans

		Fiscal Year	
	1984	1985	1986
Direct and IP (Immed. Participation)			
Number	178	248	128
Dollars	16.4	23.6	14.4

Veteran Loans

		Fiscal Year	
	1984	1985	1986
Direct and IP			
Number	294	144	299
Dollars ($'s)	19.8	8.6	19.0

SBDC CENTERS

Question:

You are proposing to reduce the funding formula for SBDC Centers in FY 1988. Please provide for the record the amount each recipient currently receives and the estimated amount each would receive under the recommended formula change.

Answer:

The proposed plan for the SBDC program is to phase out Federal funding of those SBDCs currently capped over a three-year period of time. The other SBDCs in the program that have not as yet reached their upper level of funding would be phased out over a five-year period of time.

The attached chart reflects the estimated initial impact of this phase out of Federal funding on the SBDC program for FY 1988. Some additional adjustments to the FY 1988 estimated funding level shown in the attached table may be required, in the case of some SBDC s, due to the proposed reduction of the cap from $65 million to $45 million.

See Attachment I.

SALE OF ASSETS

Questions:

1. Your request proposes the sale of loan assets commencing this year. In your opinion, does the agency have express authority to sell assets? If so, where is this authority provided?

2. What assets (and in what amount) is the agency proposing to sell?

3. When does the agency plan to proceed with this sale?

4. Does your proposal call for the sale of assets without recourse?

5. What are advantages of selling assets with or without recourse?

6. Please provide for the record the estimated return on the sale of assets with recourse and without recourse.

7. Would the funds generated from the sale of assets revert to the general fund of the Treasury or would they be used as an offset to SBA's budget?

8. Have there been any preliminary indications of interest by investors who might offer to purchase assets?

Answers:

1. Section 5(b)(2) of the Small Business Act.

2. In our 1988 budget submission we are proposing an asset sale program starting in 1987. In 1987 we plan to sell $800 million in Disaster Home Loans. In 1988 we would sell $740 million in Disaster Business Loans, $1 billion in 7(a) Business Loans and $500 million in 503 loans owned by the Federal Financing Bank, for a 1988 total of 2.24 billion.

   The submitted budget proposal estimates revenue receipts of $277 million from these asset sales to offset FY 1987 outlays and $643 million in asset sales receipts to offset the FY 1988 outlays. The actual amount, or face value, of the portfolio to be sold will depend on the actual rate of return on the sales. In other words, we plan to sell assets sufficient to meet our target for receipts in 1987 and 1988.

3. No specific date has been set at this time. We are currently in the implementation planning phase of the program. Our first major task had been to set in motion the steps necessary to obtain services of an independent financial advisor to assist the SBA in developing a marketing plan for the sale of the loans within the investment markets.

On March 30 of this year, the firm of Paine Webber was selected to provide us with such services. The selection was based on a comprehensive review of all proposals that were submitted in response to RFP (Request for Proposals) that was issued on January 23, 1987 of this year.

The Advisor's first task will be to assist SBA in the development of a comprehensive management plan for the asset sales. The plan will analyze the marketing strategies and the effects on cost and net revenue of a sale of assets both without and with partial, or full recourse to SBA. After review and any necessary modifications, SBA will consider adoption of the plan to serve as the overall strategy for the sales.

Next, the Advisor will assist SBA in structuring the loans in the portfolio into marketable units that can be readily sold to private investors. Loans could be packaged in various ways. They could , for example, be grouped or pooled in relatively homogenous units with common characteristics such as interest rates and maturity, or they might be grouped without regard to such characteristics. A pool might be established in which undivided interests in such a pool might be marketed, or used as collateral for a separate securities offering.

Finally the Advisor will develop marketing strategies to carry out the sales of the structured loan packages. Among other possibilities, marketing options might include:

-- Selling the loan packages to a single financial institution that will act as an intermediary for collection and servicing the loans on behalf of the investors;

-- Selling several packages to one or more financial intermediaries for resale to investors.

-- Sale on a local or regional basis to intermediary financial institutions which purchase for their own account; or

-- Direct sale to investors.

The investment advisor will analyze the advantages and disadvantages, anticipated proceeds, expected prices and discounts and make recommendations on the timing of the sales. SBA will then consider the recommendations contained in the final report and initiate appropriate actions.

4. Yes.

5. By selling without recourse, the government is no longer liable to cover defaults and the administrative costs of running the program are reduced.

6. We are not in a position to provide such an estimate for the record at this time as the financial advisor has not yet submitted its report.

7. Under the current procedures the funds would be deposited in the Business Loan and Investment Fund, or the Disaster Loan Fund, offsetting outlays from these Funds. Under the proposed Federal Credit Reform Act, receipts from sales of loans originated prior to 1988 would be deposited in the BLIF or DLF. Excess balances not needed to liquidate 1987 and prior year obligations would be transferred to the General Fund of the Treasury. Receipts from sales of loans originated in 1988 and subsequent years would be deposited in the Treasury.

8. SBA received one unsolicited proposal offering 23 cents on the dollar for the purchase of 7(a) direct business loans. This proposal has not been evaluated or considered because of the decision to wait for the recommendations of the Financial Advisor prior to considering any such proposals.

POLLUTION CONTROL BONDS

Question:

Is it prudent to eliminate pollution control bonds at a time when an increasing number of small businesses are found in noncompliance with federal pollution control regulations and standards?

Answer:

Terminating this particular program would, in our opinion, have an insignificant effect on the fight against pollution or the ability of the small business sector to meet the established anti-pollution standards. Since FY 1982 only 28 financing actions for a total of $59 million have occurred under this program. This would indicate that the program assisted efforts represented a very small portion of the overall effort on the part of the small businesses to abate pollution during that period. It appears that the small business sector must have been able to obtain the required funds by other means.

It should be remembered that the Congress created this program to assist the existing small businesses to meet the stringent requirements of the new environmental laws passed during the 1960's and 70's. It was felt then that the small business sector was caught unprepared. However, much time has passed and by now businesses view and provide for compliance with environmental requirements as a normal expense of doing business. Also, technology improvements in pollution abatement has expanded availability of conventional financing.

ATTACHMENT I

March 27, 1987

SMALL BUSINESS DEVELOPMENT CENTER PROGRAM
(Based on $31 million)

				Estimated	
STATE	YR ENTERED PROGRAM	YR REACHED CAP	FY 1987 FUNDING	FY 1988 FUNDING	REDUCTIONS/ INCREASES
1. Maine	1977	1985	$ 318,500	$ 254,800	$- 63,700
2. New Jersey	"	-	697,302	557,842	-139,460
3. D.C.	"	1987	635,951	508,761	-127,190
4. Georgia	"	1985	1,540,500	1,232,400	-308,100
5. Florida	"	-	2,533,789	2,027,032	-506,757
6. Missouri	"	1987	1,391,000*	1,112,800	-278,200
7. Nebraska	"	1983	442,000	353,600	- 88,400
8. Pennsylvania	1979	-	3,162,271	2,529,817	-632,454
9. S. Carolina	"	-	800,000	640,000	-160,000
10. Wisconsin	"	1984	1,326,000	1,060,800	-265,200
11. Minnesota	"	1986	1,100,000	880,000	-220,000
12. Arkansas	"	1985	643,500	514,800	-128,700
13. Utah	"	1984	409,500	327,600	- 81,900
14. Washington	"	-	1,113,372	890,698	-222,674
15. Mass.	1980	-	1,294,247*	1,035,398	-258,849
16. Alabama	"	1986	0 1/	878,800	-219,700
17. Connecticut	1981	-	528,208	422,567	-105,641
18. Mississippi	"	1985	0 1/	572,000	-143,000
19. Kentucky	"	1986	1,033,500*	826,800	-206,700
20. Iowa	"	1985	825,500*	660,400	-165,100
21. Vermont	1982	1984	200,000*	200,000	-
22. W. Virginia	1983	1987	552,000	441,600	-110,400
23. Delaware	"	-	200,000*	200,000	-
24. Rhode Island	"	1986	266,500	213,200	- 53,300
25. Michigan	"	-	2,017,000*	1,613,600	-403,400
26. Louisiana	"	-	905,681*	724,545	-181,136
27. Kansas	1984	1987	669,500	669,500	-
28. Illinois	"	-	1,175,000	1,175,000	-
29. Tennessee	"	-	634,674	634,674	-
30. Oregon	"	-	646,375	646,375	-
31. N. Hampshire	"	-	235,000	235,000	-
32. NY (Upstate)	"	-	0 1/	620,000	-
33. Oklahoma	"	-	562,124	562,124	-
34. TX (Houston)	"	-	626,362*	626,362	-
35. N. Carolina	"	-	467,755	467,755	-
36. N. Dakota	1985	-	156,000	179,400	+ 23,400
37. Puerto Rico	"	-	269,673	310,123	+ 40,450
38. NY (Downstate)	"	-	548,119	630,336	+ 82,217
39. South Dakota	"	1986	200,000	200,000	-
40. Virgin Islands	"	-	145,029	166,783	+ 21,754
41. Wyoming	"	1985	200,000*	200,000	-
42. Indiana	"	-	388,500	446,775	+ 58,275
43. Nevada	"	1987	227,500	227,500	-
44. Idaho	1986	-	266,500	266,500	-
45. Ohio	"	-	350,000	437,500	+ 87,500
46. TX (Dallas)	"	-	375,000*	468,750	+ 93,750
47. TX (Lubbock)	"	-	231,830*	289,787	+ 57,957
48. TX (San Ant)	"	-	283,258	354,072	+ 70,814
49. Alaska	1987	1987	200,000	200,000	-
			$ 32,794,520	30,694,176	

1/ To be refunded out of FY 1988 funds.

* Estimated FY 1987 funding level. Will not be refunded until 9/30/87.

NOTE: Minimum cap ($200,000), funding not reduced.